

## FINANCING FULL EMPLOYMENT

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# FINANCING FULL EMPLOYMENT

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## Preface

**T**HIS BOOK was written while I was a member of the faculty of the Graduate School of Business Administration of Harvard University. Its publication was directly due to the support of Dean Donald K. David, Professor Melvin T. Copeland, Director of Research, and Professor Stanley F. Teele, Associate Director of Research. Their support is appreciated by me.

Several of my Business School colleagues read the manuscript—George Bates, J. Keith Butters, Donald T. Clark, Henry C. Hawley, Pearson Hunt, and Malcolm P. McNair. All made helpful and penetrating comments; and I wish to thank them.

The main theme of the book is bold and unorthodox. It may, therefore, seem startling to the reader. If so, the reader may be interested to know that others who have found it startling on first acquaintance have changed their opinions after thoughtful consideration.

J. P. WERNETTE

*August 20, 1945*



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## FINANCING FULL EMPLOYMENT





## CHAPTER I

# The Development of the Problem

THIS BOOK is concerned with the problem of how the United States of America can achieve and maintain full employment and prosperity in the decades that lie ahead of us, while encouraging and strengthening free enterprise. The book deals especially with the contribution toward that goal which could be made by a new monetary system and its associated fiscal policies. I have called the monetary system the Full Employment Standard. Explanations of its nature and its necessity come in later chapters.

Lest confusion be generated by our thinking about different things, I wish to repeat and emphasize the thought contained in the first sentence above. This book is not concerned primarily with the problems of the immediate postwar period—the period that is variously called that of demobilization, or reconversion, or catching up. This book is primarily concerned with the long period that will come after the reconversion period, when the turbulence of readjustment is over, and the nation settles down to the ways of what we all hope will be permanent peace.

## THE POSTWAR OUTLOOK

From the end of the war, and thereafter into the indefinite future, the principal economic problem of the United States of America will be how to maintain full employment, how to provide jobs for all willing workers, how to realize the large prosperity that is technically possible.

The problem, of course, is not new. It was acute for a decade before the war. The war caused unemployment to disappear; but its disappearance is generally believed to be the result of war activities which were temporary. The condition of full employment was therefore feared to be likewise temporary; and it is expected that after the war is over and on into the future, the nation will be right back where it was before the war started—facing the unemployment problem. During the prewar decade there were never fewer than seven million unemployed; and at the worst of the depression the figure may have reached fourteen million. Because of the continual increase in productive efficiency and per capita output, it is anticipated that these unemployment figures could easily be exceeded in the future.

That these worries about the future employment situation were not limited to a few economic analysts was indicated by two public opinion polls in December 1944. The polls showed that the American people as a whole were pessimistic about the outlook.

The Gallup poll asked a cross section of people: "After the war do you think that everyone who wants a job will be able to get one?" Of those queried, 7 per cent had no opinion, 25 per cent answered Yes, and 68 per cent said that they did not think so. The *Fortune* survey asked people whether they thought that we would have a severe depression within ten years after the war. Of the people questioned, 10 per cent replied that they didn't know, 41 per cent said No, and 49 per cent said Yes.

These gloomy opinions may seem strange, coming from the American people—a people who often have been described as optimistic and venturesome. The exist-

ence of this pessimism gives rise to some important questions. Why are our people now so pessimistic with regard to the future? And are their gloomy views transitory and irrational, or do they have some reasonable basis? Unfortunately, these opinions cannot be dismissed as being unreasonable. These worries are based on the economic experience of the past fifteen years. This decade and a half has shocked our people and bewildered them. The unemployment record of the period was, as Table 1 shows, a gloomy one until the war started.

#### THE GREAT DEPRESSION

Until 1929, we Americans were, on the whole, buoyant and optimistic about the future. What is more, that feeling had a good sound basis. It was based on a long history of phenomenal economic progress, which had brought to the average American the highest standard of living in the world—and at a rate of increase so rapid that a man could see it happening to him in his own lifetime. No wonder that Americans believed theirs to be the land of opportunity! The captain of industry who said, "Don't sell America short," was not unique in his confidence; he merely expressed in stock market language a view probably shared by ninety-nine out of every hundred of his countrymen. In 1929, the national income reached 83.4 billion dollars.

Since 1929, however, that confidence and that bold optimism have been seriously diminished. The process of psychological collapse was not fast, however; on the contrary, it was slow. In 1930 many persons believed that the "recession" would be brief and unimportant. By 1931, however, the thing was serious; and by another

year it was desperate. By the winter of 1932-1933, there were fourteen million unemployed. Those who were employed worked short hours at reduced wages. The national income had dropped to 40 billions—less than half what it had been in 1929. The country may have been close to a social upheaval. Actually, the 1932 election apparently provided an outlet for the public discontent.

Then, in 1933, mounting desperation was checked, as a modest improvement began. But when, however, the country went into another tail spin in 1937, before full recovery had been achieved (there were still eight million unemployed), the Great Depression was breaking its own record of length and severity. Different experts offered different explanations—some talked about national economic maturity, others about unsound governmental policies, or economic inflexibility. Most men, however, probably were merely confused, and wondered what was going to happen in the future.

#### WAR AND PROSPERITY

Then in 1939 a series of dramatic and vital events began. War started in Europe in September. In the following year the American Defense Program was initiated. In the next year, on December 7, came Pearl Harbor and the entry of the United States into the war. Prior to December 7, 1941, war and defense spending (foreign and domestic) had stimulated business activity noticeably. After Pearl Harbor, however, the expenditures were increased enormously, and the country's farms and factories gradually went into high gear. Despite the withdrawal first of hundreds of thousands and then millions of the most physically fit men from production as

TABLE I  
EMPLOYMENT AND UNEMPLOYMENT, 1929-1944  
(Annual Averages)

Year	Number Employed	Number Unemployed	Civilian Labor Force	Per cent of Civilian Labor Force Employed	Unemployed
<i>(In millions of persons)</i>					
1929 ...	46.4	2.9	49.3	94.1%	5.9%
1930 ...	44.2	5.7	49.9	88.6	11.4
1931 ...	41.0	9.4	50.4	81.3	18.7
1932 ...	37.3	13.6	50.9	73.3	26.7
1933 ...	37.5	13.9	51.4	73.0	27.0
1934 ...	39.9	12.0	51.9	76.9	23.1
1935 ...	41.2	11.2	52.4	78.6	21.4
1936 ...	43.2	9.8	53.0	81.5	18.5
1937 ...	44.9	8.6	53.5	83.9	16.1
1938 ...	42.9	11.2	54.1	79.3	20.7
1939 ...	44.2	10.4	54.6	81.0	19.0
Change in series					
1940 ...	45.1	8.0	53.1	84.9	15.1
1941 ...	46.0	6.0	52.0	88.4	11.6
1942 ...	50.2	3.2	53.4	94.0	6.0
1943 ...	51.2	1.1	52.3	97.9	2.1
1944 ...	50.5	.9	51.4	98.2	1.8

Sources: For 1929-1939, Committee for Economic Development, Data Sheet No. 3. For 1940-1944, Bureau of the Census estimates for March; reported in Survey of Current Business, May 1944, p. 4. Between 1939 and 1944, the number of persons in the Armed Forces rose from about .3 million to about 12 million.

they entered the Armed Forces, the great American economic machine moved up to higher and higher speeds. Month after month production records were broken, until by 1943 total industrial production was twice as great as in 1940.

There were plenty of jobs. Employment went up, un-

employment went down. By 1944 there were only one million unemployed, a number probably smaller than normal for a dynamic country. Production shot up, profits grew, unemployment practically vanished, incomes soared. The total national income, which had slumped to 40 billion dollars in 1933, rose rapidly, and was 148 billions in 1943. Even after paying the higher war taxes, and despite rationing, the American people were enjoying real prosperity for the first time in many years.

This war-boom prosperity did not, however, dispel the pessimism of the thirties. The pre-1929 confident optimism was not restored. People understood that the enormous war expenditures were producing a peculiar prosperity; but many doubted that prosperity would continue when the war expenditures ceased. Indeed, the prospective and inevitable cessation of war expenditures was a grave cause for worry. Doubt, uncertainty, and even gloom about the future continued at about the same level as had been generated by the Dismal Thirties.

Actually, these developments caused new confusion—people were puzzled by the fact that in wartime the nation was able to achieve a far higher level of prosperity than in recent peacetime.

#### THE NATION'S DILEMMA

Indeed, the sequence of events since 1929 suggests this rather dreadful question: Does the United States have this miserable choice—must the nation choose between Peace-and-Depression, and War-and-Prosperity?

Although it is a dreadful question, it is not an improper or fantastic one. The period since 1929 has in

fact been divided into two parts. From 1929 to 1939 the country experienced peace and depression. After 1939, impending and actual war was accompanied by a peculiar but not unreal prosperity. Indeed, in the war young Americans who actually never knew the happy combination of Peace-and-Prosperity have given their lives for their country.

Does the United States in fact face this wretched choice? Do we have to choose between Peace-and-Depression and War-and-Prosperity? This is a vital question; and one that deserves a fair answer. I can here give only a summary answer, but the matter will be discussed and analyzed at length in subsequent chapters.

Immediately after the war there will be a brief re-stocking period, when business and employment will be fairly good. When the re-stocking stimulus has spent its force, however, the outlook for the decades ahead is for continuous, chronic mild depression, broken by occasional periods of severe depression. That is what we may expect, *unless something is done to prevent it*.

#### FACTORS IN A PROSPERITY PROGRAM

This book is concerned with what ought to be done to prevent it. The principal suggestion will be the adoption of a new fiscal-monetary system which I have called the Full Employment Standard. This is not, however, the only thing that should be done. An adequate prosperity program would include other policies and mechanisms. Certain of these will be discussed following the exposition of the Full Employment Standard.

These other factors include (1) control of bank credit by the Federal Reserve System, (2) compensatory fiscal

operations, and (3) various policies designed to encourage enterprise and employment. Since these plans and policies have been the subject of much analysis and discussion in recent years, they are quite well known, and most of them already enjoy a substantial measure of acceptance. Therefore, they are discussed rather briefly in this book. The purpose of the discussion is not to expound them, but, rather, to show how they and the Full Employment Standard complement one another and together comprise an adequate prosperity program.

#### THE MAINTENANCE OF FREE PRIVATE ENTERPRISE

Certain things need to be said plainly at the outset. The principal suggestion of this book—the Full Employment Standard—is unorthodox. Moreover, the basic idea of the entire program is that the Federal government has the ultimate responsibility for maintaining the conditions of full employment.

These facts may suggest that the program represents a long step away from the American free enterprise system as we have known it in the past, and a long step in the direction of a government-controlled economy.

This is not true. Since the proposals have not been described as yet, no complete statement is possible. In summary, however, the program is posited upon a continuation of private enterprise.

The entire purpose of the program is to keep private enterprise from collapsing in some great future depression; to keep private enterprise alive by underwriting a big market for the goods and services which private business can produce.

The suggested program (and particularly the Full Em-



ployment Standard) may seem radical. In the broadest sense of the word, however, it is not; it is conservative. It aims at conserving the free enterprise system by keeping it strong and prosperous and able to provide full employment for our people.

## The Nature of the Problem

BEFORE GOING on into the exposition of stabilization measures it may be helpful to review certain ideas about the basic nature of mass unemployment. This discussion will involve a brief analysis of the characteristics of general business fluctuations ("business cycles"), and especially the circumstances that bring about and prolong depressions.

This discussion of the unemployment problem will provide a basis for understanding what the elements of an adequate solution must include, and what characteristics a prosperity program must possess in order to be successful.

### THE TWO POSTWAR PERIODS

Careful analysis of the future unemployment problem requires dividing the postwar future into two periods. The first may be called the *transition period*; it covers the months or years, possibly not more than two years, while the United States is changing back from a wartime economy to a peacetime economy. This process involves the cessation of production of military goods, the release of men from the armed forces, and resumption of employment and production in civilian goods. The second period may be called the *normalcy period*; it comes as the transition from war to peace is accomplished, and the country is once again operating on a genuine peacetime basis.

It now seems that the transition period is more likely to be a time of considerable business activity than one of

depression. Pent-up desires for civilian goods, which by themselves are not enough, will be accompanied, however, by pent-up purchasing power which is more significant; and there will also be a resumption of installment buying, and building of plants and machinery. These factors together will provide an active and ready market for civilian goods, and industries will be able to absorb most of the returning soldiers without a great deal of difficulty, as rapidly as the plants can be converted and materials become available.

The real problems will come when this postwar flush is exhausted, and we settle down to the routine business of peace, the war and its effects having been left behind. In those future decades the occurrence and nature of unemployment will follow the same pattern as in the pre-war era—in the absence of effective control measures, the country's economy will be rescued occasionally from its normal condition of semi-employment by the fortuitous appearance of a large stream of extremely attractive-looking investments. The investments do not need to be sound and profitable *in fact*; they merely need to *look* attractive at the time. If they look attractive, investors and business managers will buy securities and capital goods. These outlays will provide employment, even though the investments turn out to be worthless later on. At any time, however, that the stream of attractive-looking investments decreases or the investing ardor of the public is chilled, unemployment will start to rise, and then to grow cumulatively. This has been the pattern in the past, and the cyclical fluctuations are likely to be larger rather than smaller in the future.

## THE NATIONAL DEBT

The principal new factor in the picture which will cause the postwar problem to be somewhat more difficult than the prewar problem will be the presence of a very considerably enlarged national debt; it looks as though the debt would be somewhere in the vicinity of 300 billions.

There is a time-honored doctrine that an internal domestic governmental debt is really no burden to the nation. The supporting argument runs like this: (1) We really owe the debt to ourselves, and a debt owed to oneself is not a burden; (2) Opposed to the debt are the bonds; in a consolidated national balance sheet, bonds and debt would cancel out and disappear; (3) The interest charges and amortization payments do have to be paid out of higher taxes, but they are paid right back to the American people, so that the people have neither more nor less income or capital than they have before; (4) For these reasons an internal domestic governmental debt is no burden.

This is a plausible line of argument, but one which rests on misleading consolidation of the balance sheets and income statements of all of the American people into one balance sheet and one income statement.

Actually, the huge debt is a burden. It is a deterrent to enterprise for two reasons. One reason is that most persons seem to believe that it is a burden, and they worry about it. Their fears may or may not be rational. Their worries may or may not be exaggerated. But if they exist, and they certainly seem to, they must be reckoned

as making a large debt an adverse factor psychologically, because people's minds are troubled.

The second reason why a large Federal debt is a burden is that its servicing requires taxes, and the amount of taxes that an individual or a corporation pays has no connection whatsoever with the amount of interest (if any) that the person receives on owned Federal bonds. If the person makes an investment, and it turns out well, he (or the corporation, if a corporation) will have to pay more taxes. If it turns out badly, however, will the government share the loss in the same ratio?

Now in fact it is not possible to say whether the government will, in any given case, share the gains and losses proportionately. In certain cases, they will be shared proportionately. In others the gains will be taxed heavily, and the losses shared but little. Conversely, in certain cases the gains will be taxed lightly, and the losses will be borne largely by the government.

In the case of a flat-rate corporation income tax, if a corporation has sufficient taxable income to absorb the losses taken in unsuccessful ventures, the government shares the losses on such ventures in the same percentage as it shares the gains on successful ventures. The losses are charged against other income, and the corporation's income tax payment is thereby reduced. In these circumstances, it is arguable that risky investments are not penalized as compared to safe investments, since the government shares the losses as well as the gains.

But this argument may not be carried any farther—it does not follow that the tax is not a deterrent to investment of both types. In fact, the tax does deter both safe

and risky investments. The argument of the preceding paragraph is merely that the effect of the tax upon the two types of capital ventures is equal.

Capital outlays are not made with the expectation of probable loss, but rather with the expectation of probable gain. Therefore the investor views the tax as a deduction from an anticipated probable gain, which lowers the amount of the gain. In other words, the investor visualizes himself after taking several risks (and losing on some of them) as coming out ahead on the total, and having to share the net gains with the government.

Apart from these mathematical considerations there remains the widespread feeling among the citizenry that taxes make investments less attractive; and if the feeling influences behavior, then taxes do discourage investment.

The argument that a domestic governmental debt is not a burden, or that it is only a small burden, has been heard frequently of late in support of a fiscal policy under which the deficits might exceed the surpluses and, if so, the debt would rise through the years. *The basic fiscal policy is sound; but the deficits should not be financed by increasing the debt (which is a burden), but by creating new money (which would be a stimulating factor).* Indeed, the war debt itself should be gradually paid off as a part of the same fiscal policy. These matters will be discussed in detail in a later section.

#### THE BASIC NATURE OF THE CYCLICAL UNEMPLOYMENT PROBLEM

The instability of employment under our economic system flows from a dilemma involving two factors: (1) The *steady* net desire on the part of the people as a

whole to save a substantial portion of their incomes; and (2) The *unsteady* willingness on the part of would-be savers to *invest* their savings, plus the unsteady willingness of other persons, e.g., corporation managers, to invest the capital funds which they control.

The people of the United States secure employment in the broadest sense by employing one another. They employ one another by spending money for goods and services. Consumers buy consumers goods—food, clothing, automobiles, etc. Businesses buy raw materials and equipment, build buildings, and hire laborers. The people as a whole, however, including the corporations, are also disposed to *save*; that is, not to spend the whole of their current incomes. How then, if the people wish to consume less than their current incomes, can they earn incomes in excess of what they pay each other for current production? In somewhat oversimplified terms, the answer is that, if someone is willing to *invest*, by employing people to make something not currently consumed, the difficulty is solved. This excess of income over consumption can be provided in three principal ways: (1) by building up the nation's plants; (2) by increasing the country's inventories; and (3) by increasing the quantity of money so that people take in more cash than they lay out on either investment or consumption, thus retaining the remainder.

Processes (1) and (2) mean that people are putting their money into *things*, either directly via the purchase of bricks and machinery, or indirectly by purchasing securities. These investing processes ordinarily occur only when people have confidence that such operations will turn out to be profitable. This confidence is usually

a delicate flower, although it flourishes with weed-like vigor at infrequent intervals. If something happens to chill the enthusiasm of investors so that they reduce their investing, how do the men who were employed in building plants, making machinery, and increasing inventories find work? The blunt and simple answer is that they don't.

Do they fail to find employment because the people who formerly saved and invested now do not wish to save and want to spend all their money on consumer goods? The answer to this is a plain and definite No. The people still want to save, but they do not want to invest, so they reduce their investing or stop altogether. Then something happens which illustrates the difference between *individual* business operations and *group* economic processes. If the would-be savers reduce their investing, they throw people out of work. The newly disemployed then reduce their spending; and the upshot of the process is that the total income of the people of the country goes down. This reduction in general income reacts upon the would-be savers, and they presently find that their incomes have gone down, that the money which they hoped to save but not invest is no longer coming in. The result is that, broadly speaking and for the people as a whole, but not, let it be emphasized, for every single individual, the total of actual *saving* goes down just as fast as the total of actual *investing*.

This consequence occurs because the savers as a group are trying to do something which under the ordinary working of our monetary system is impossible. The savers are predominantly trying to save money without investing it. This would mean that the people as a whole



are trying to accumulate more cash. Now the people as a whole cannot accumulate more cash unless the total quantity of money is increased, and there is nothing in the present monetary system to cause the total quantity of money to grow in those circumstances and at precisely that time. This leads to the very natural conclusion that whenever the investors want to stop investing and start saving cash, if it were possible to switch the workmen who had been building plants and making new machinery to *figuratively making new money*, we could accomplish the trick of preserving employment, keeping the total of incomes up, and at the same time satisfying the desire of the public to save money without investing it. It is possible; the Full Employment Standard is a monetary mechanism for doing exactly these things.

#### FLUCTUATIONS IN SPENDING

When we as a people spend our money freely (on consumers goods and capital goods) we have prosperity and full employment. When we spend cautiously we have depression and unemployment. In the next chapter the suggestion will be made that the total rate of spending depends to a large extent on the total amount of money which the people possess. For the present, let us look at some figures which show the fluctuations in the national spending rate over the past fifty-five years. Strictly speaking there is no statistical figure which measures exactly the rate of spending. The figures on bank debits and bank clearings, however, probably are a fairly accurate indicator of the total volume of spending. Of the two, bank debits are more inclusive; but these data run back only to 1919. For earlier years the statistics of bank

clearings must be used. Tables 2 and 3 show these banking figures from 1885 through 1941.

These tables show the drop in spending which occurred at the time of the Panic of 1907, and again in the

TABLE 2  
BANK CLEARINGS, MONEY, AND TURNOVER, 1885-1919  
(*Money figures in millions*)

Year	Bank Clearings	Total Money	Annual Turnover Rate	Adjusted Annual Turnover Rate
1885 .....	\$ 37,770	\$ 4,027	9.4	20.2
1890 .....	59,882	5,503	10.9	23.4
1892 .....	60,884	5,838	10.4	22.4
1893 .....	58,881	5,868	10.0	21.5
1894 .....	45,028	5,787	7.8	16.8
1895 .....	50,975	6,032	9.9	21.3
1896 .....	51,936	6,048	8.6	18.5
1897 .....	54,180	6,205	8.7	18.7
1898 .....	65,925	7,032	9.4	20.2
1899 .....	88,829	8,036	11.1	23.9
1900 .....	84,582	8,865	9.6	20.6
1901 .....	114,820	10,013	11.5	24.7
1902 .....	115,892	10,839	10.7	23.0
1903 .....	113,963	11,452	10.0	21.5
1904 .....	102,356	11,973	8.6	18.5
1905 .....	140,502	13,237	10.6	22.8
1906 .....	157,681	14,121	10.2	21.9
1907 .....	154,477	15,102	10.2	21.9
1908 .....	126,239	14,718	8.6	18.5
1909 .....	158,877	15,794	10.0	21.5
1910 .....	168,987	16,977	9.9	21.3
1911 .....	159,540	17,762	9.0	19.4
1912 .....	168,686	18,865	8.9	19.1
1913 .....	173,193	19,403	8.9	19.1
1914 .....	163,850	20,031	8.2	17.6

TABLE 2 (*continued*)

Year	Bank Clearings	Total Money	Annual Turnover Rate	Adjusted Annual Turnover Rate
1915 .....	\$163,189	\$20,682	7.9	17.0
1916 .....	242,236	24,201	10.0	21.5
1917 .....	305,062	28,154	10.8	23.2
1918 .....	320,989	31,423	10.2	21.9
1919 .....	387,854	35,605	10.9	23.4

Source of figures for bank clearings: *Statistical Abstract of the United States, 1937*, p. 268.

The adjusted turnover rate is the actual annual rate multiplied by 2.15, to enable comparison with the annual turnover rates in the following table. The figure 2.15 is the ratio for the overlapping years, 1919-1930, between the annual turnover rate for bank clearings in the foregoing table and the annual turnover rate for bank debits in the following table.

sharp business decline of 1920-1922. But these rather small and short-lived declines in spending were insignificant compared with the large and long decline of the thirties. After 1907 the decline in the annual total of spending lasted two years, and represented a decrease of 20 per cent; and the 1906 pre-panic figure was surpassed in 1909. After 1920, the spending decline lasted one year, and amounted to 18 per cent; the 1920 pre-slump rate was surpassed in 1925. After 1929, the decline lasted four years, and represented a drop of 66 per cent; the 1929 spending rate had not been regained twelve years later. In the next chapter it will be suggested that the prolonged drop in spending after 1929 was due largely to the substantial decline in the nation's money supply which occurred at that time.

TABLE 3  
BANK DEBITS AND DEPOSIT TURNOVER, EXCLUDING INTERBANK DE-  
POSITS AND COLLECTION ITEMS, AT ALL COMMERCIAL  
BANKS, 1919-1941  
Total Demand and Time Deposits  
(Debits and deposits in millions)

Year	Debits	All Commercial Banks	
		Demand and Time Deposits	Annual Turnover Rate
1919 .....	\$ 663,000	\$27,060	24.5
1920 .....	721,000	30,350	23.8
1921 .....	591,000	28,400	20.8
1922 .....	643,000	29,750	21.6
1923 .....	685,000	32,920	20.8
1924 .....	716,000	34,590	20.7
1925 .....	820,000	37,720	21.7
1926 .....	872,000	39,340	22.2
1927 .....	952,000	40,670	23.4
1928 .....	1,114,000	42,570	26.2
1929 .....	1,276,000	42,720	29.9
1930 .....	931,000	41,550	22.4
1931 .....	685,000	37,830	18.1
1932 .....	471,000	31,720	14.8
1933 .....	437,000	28,500	15.3
1934 .....	491,000	30,640	16.0
1935 .....	547,000	34,610	15.8
1936 .....	628,000	38,660	16.2
1937 .....	650,000	40,290	16.1
1938 .....	566,000	40,410	14.0
1939 .....	592,000	43,670	13.6
1940 .....	627,000	48,610	12.9
1941 .....	756,000	54,110	14.0

Source: Federal Reserve *Banking and Monetary Statistics*,  
p. 254.

THE NECESSARY CHARACTERISTICS  
OF A SUCCESSFUL PROGRAM

Neither analysis nor experience suggests that a satisfactory solution for the unemployment problem had been found before the war started. Since the problem is going to be even tougher after the war, because of the enormous Federal debt burden and the technological increase in productivity, the need for a satisfactory solution is even greater. The solution must have certain definite characteristics:

1. It must be *potent*. A program consisting merely of pious hopes, or surveys, or feeble assistance, will not do.

2. It must provide *fluctuating*, rather than *steady* stimulus and support—stimulus being given conversely to the ability of industry to provide enough jobs.

3. It must not require either the continuation, or worse, the enlargement of the Federal debt.

4. It must involve a minimum of governmental regulation of industry; and it must be consistent with policies designed to encourage business enterprise.

5. It must do two things in time of incipient depression:

- (a) Prevent the cumulative spread of declining investment, by sustaining the monetary income of the whole people and thus maintaining industry's markets for goods and services and the volume of spending, and

- (b) Provide employment for those who, despite this situation, lose their jobs.

That set of specifications may look like a big order; and it is. But no smaller order would be satisfactory.

#### THE ALTERNATIVES AHEAD OF THE UNITED STATES

Postwar America can be, economically, either a rather wonderful place, or it can be a dreary land of unemployment, doubt, confusion, and, finally, upheaval.

Unless adequate means can be developed to keep the huge unruly American economic machine going at full speed all the time, there are likely to be very few periods when the number of unemployed will get down to the frictional minimum, which seems to be about 5 per cent of the work force, or about 2.5 to 3 million men and women. Most of the time I would expect approximately 10 to 12 million unemployed, since the remaining 45 to 47 million could easily produce all the goods that there would be monetary demand for in most years. Periodically, perhaps every ten years, a really severe depression would occur and the number of unemployed will soar to 20 or 22 million. This phenomenon, however, might not occur "periodically"; it would probably occur only once, and would precipitate an upheaval.

If, say around 1960, the number of unemployed were to get up to around 22 million, we might expect to witness a major change in the American social-political-economic system. It might be a disorganized, anarchical process, in which desperate men seized factories, stores, and goods. Or the change might usher in a systematic collective state called "Socialism" or "Communism." More likely, however, I think it would be called something like "American Progressivism," and would be a

somewhat confused mixture of individualism and collectivism, without any definite philosophy, but promising jobs for all.

#### THE OTHER POSSIBILITY

The gloomy picture, however, is not the only possibility. There is another that is so bright that it somewhat strains the imagination. With full employment, a continued rapid rate of technological progress, an enlarged accumulation of production capital, progress in human education and training, the real income of the average American family in 1950 could be about 50 per cent higher than in 1929. In specific terms, this would mean for most families abundant good food, attractive clothing, an automobile, and a brand-new house to be built within ten years of the war's end; and all this on a five-day work week. This picture, cheerful though it is, is not fantastic. It is quite within the bounds of the mechanical productive capacity of the American economic engine. We may not hit it, because of inertia, or incompetent handling of the employment problem; but if we don't realize the bright dream the failure will be financial, not industrial. This book aims at elucidating the financial arrangements that will allow the engineers to run the machine at full speed, and produce the highest standard of living yet, for the American people.

#### THE DANGER OF RELYING ON INADEQUATE SOLUTIONS

In this section attention will be given to certain proposals, plans, and activities which currently interest many persons but which do not strike the present writer as be-

ing very effective. What, it may be asked, is the use of taking time and space to evaluate such proposals? Why not just present the favored proposals, and not bother with the others?

These are reasonable questions, and they are entitled to a fair answer. The explanation is this: Some ineffective proposals impress many persons as being potent and adequate; these plans therefore may be adopted and relied on to do the trick; their subsequent failure would be a ghastly tragedy for the United States, and might even be catastrophic. It is not wise to be tolerant of inadequate solutions for the nation's problem or to comment, "Well, it can do no harm." In fact, an ineffective solution can do harm, if it prevents interest in and adoption of a really adequate plan. Utilizing a plausible but useless prosperity proposal would be like incorporating an unsound engineering principle into buildings under the delusion that it would make them earthquake-proof. The self-deception would get a rude and tragic shock when the earthquake came and the buildings collapsed. If the attractiveness of inadequate prosperity plans causes their adoption and the rejection of a genuinely adequate program, the stage would be set for what might be the depression that would end the present American political-social-economic system.

#### JOB SURVEYS

A current type of such planning is making job surveys. Employers are asked by questionnaire how many men they expect to be able to employ after the war, and the answers are tabulated and analyzed. This process avoids theorizing, is "practical," and involves no new or doubt-



ful mechanisms. There is really only one adverse criticism—the program does not create any stabilized employment. It does not *create* jobs; it merely *counts* jobs. Perhaps the count will show that the number of anticipated jobs is enough to absorb all the workers; perhaps it will not. Whatever the result of the count, the process does not change the quantity of employment, or change what it will be the following year, and the year after that.

This process is merely a sort of forecasting operation, like forecasting the temperature—"warmer" or "cooler." The weather forecast does not provide any warmth or any coldness. Making the forecast does nothing to influence the temperature.

So, similarly, the making of job counts or job surveys does not affect the grand total of employment opportunities, one way or the other.

#### INDUSTRIAL PLANNING

An activity which has attracted some attention as an employment-maker is a special form of industrial planning, in which a company sets itself this problem: Assuming full employment after the war, and the corresponding large national income that goes with full employment, how many of each of the many items made by our company would we sell, and should we therefore plan to manufacture? This problem is an intricate one, worthy of the best efforts of analysts and statisticians; and certain products of their analysis indicate clearly the high level of competence brought to bear on the problem.

This activity, however, does not *create* any employment, nor does it reduce the number of jobs; it does not affect the number of jobs. This activity is also *fore-*

*casting*; it does not influence the situation any more than the weather man's forecast affects the temperature.

This comment can be understood best, perhaps, by another approach. The company could start its experts on another problem, with another assumption: Assuming a depression, with 20 million unemployed, how many of each of our products would we sell? This would be basically the same problem as before, and its solution would require the same degree of skill and competence on the part of statisticians and analysts. In fact, the experts could work on *both problems simultaneously*. (As a matter of fact, the methods used, such as multiple correlation and extrapolation, would produce answers to both, whether or not it was so intended.) Merely making the assumption of prosperity for analytical purposes would not bring prosperity into being any more than making the assumption of depression would cause widespread unemployment. These assumptions are merely analytical devices. Both assumptions could be made at once, and, indeed, *should be*, so that the company will be prepared for either condition, as the future unfolds.

This process is really not new. Competent sales managers have been doing it for years. They call it "sales forecasting" or "sales budgeting." The results are used for two purposes—setting sales quotas (often with psychologically-determined revisions), and scheduling merchandising and manufacturing operations. In these uses, sales forecasting is a useful tool of business management. But until recently no one thought that sales forecasting *made* the future; sales forecasting merely *read* the future. And that is still the best it can do.

## INDUSTRY AND EMPLOYMENT

Herewith a comment that applies to both of the preceding short sections, and, in a larger sense, to the entire problem. The American system contemplates the majority of workers finding jobs in *private* industry, rather than working for the government. Private industry, however, is limited in the number of jobs that it can offer. Private industry can hire enough workers to make the goods that it can sell currently and expects to sell in the relevant future—neither more nor less. When industry sells its goods readily, employment is high. When sales slump, employment declines.

To be sure, the two preceding sentences might have been inverted, since it is true that when employment rises, sales go up also; when employment falls, sales decrease. The causal interrelationship is subtle and intricate. But the stubborn fact remains that the eyes of industry see sales as the controlling factor, employment as the result. Therefore, a full employment program will be successful in keeping private industrial employment at a high level only if it offers industry a continuous large market for its goods. That is the aim of the program presented in this book. There is perhaps no form of encouragement to business confidence that surpasses a guaranteed large market for industry's goods.

## THE STABILIZATION ORGANIZATION

Since the American economic system is inherently unstable, a stabilization program must attempt to reduce the inherent instability and/or to introduce a mechanism of countervailing actions—repression if the individual

enterprise machine gets to running too rapidly, and stimulus if the machine runs too slowly.

Some of the policies, once inaugurated, would require little subsequent administration or management, either because they are steady and continuous, or because they are automatic in their compensatory action. Other policies, however, would require management—actions, now one way, now the other.

In any event, the need for discretionary management and the desirability of having the entire program and situation continuously analyzed and coördinated indicate the importance of vesting the responsibility and appropriate authority in a distinguished Federal agency. This agency might be named the Federal Stabilization Board.

I visualize the operating organization something like this. The Federal Stabilization Board would be a kind of outgrowth and magnification of the present Federal Reserve Board of Governors. It would take over the powers and duties of the Reserve Board, and acquire some new ones.

The Board would be assisted by a Federal Stabilization Advisory Committee, composed of representatives of the executive and legislative branches of the government. The necessity for such an advisory committee arises from the complexity of the program, and the multiplicity of interests and responsibilities that are involved. The Advisory Committee should have members representing the departments of the Treasury, Agriculture, Commerce, Labor, and perhaps others. The Committee should include Senators and Representatives from selected Senate and House committees—those dealing with

fiscal matters, banking and monetary problems, and other key stabilization factors.

The operations of the Board and the Advisory Committee will be discussed at greater length in a later section, with reference to the management of the prosperity program.

#### THE AIM OF STABILIZATION

Perhaps the first problem of stabilization is this: What are we aiming to stabilize? The answer to this question has been implied in all of the discussion up to this point; but it is just as well to state it explicitly. The aim of the stabilization program is the maintenance of full employment. Full employment also means prosperity and a full-size national income.

The reason for stressing this aim explicitly is that much monetary reasoning has had in view the stabilization of the price level. These two aims are not entirely unlike. Successful stabilization of employment would involve (as both a result and a cause) cyclical stability of prices. In other words, the elimination of cyclical fluctuations in employment would also mean the elimination of cyclical price fluctuations.

But the term "stabilization of prices" has another meaning. It also means a *horizontal* price level. The two are not the same. Cyclical price stability could be accompanied by any of three secular trends—rising, falling, or horizontal. Stabilization of employment does not necessarily mean a stable horizontal price level. It might mean that; or it might mean a slowly rising price level or a slowly falling price level. In either case, wage rates would have to increase relative to the cost of living, thus

permitting the secular increase in per capita production to yield higher real wages.

It is not, however, predictable which of the three long-time patterns of prices would emerge from a successful employment stabilization program. The important thing is to identify the basic aim—full employment—and to concentrate on it, without confusion, and with the understanding that the secular trend of prices which emerges is the one best suited to the economy.

## CHAPTER 3

# Money in an Expanding Economy

**B**Y WAY of assisting the reader in seeing how the analysis in this chapter is related to the proposed Full Employment Standard, it is appropriate to describe the proposal briefly. Even though the line of argument that supports the proposal is just beginning here, the drift of the argument will probably be clearer if the standard is understood in advance.

### THE FULL EMPLOYMENT STANDARD

Additions to our country's supply of money, under our present monetary arrangements, result from gold increments or the expansion of bank credit; decreases in our money, from reductions in gold or bank credit. There is no basic plan or philosophy that governs the total quantity; and this is its serious failing.

The Full Employment Standard proposes:

1. That control of the total amount of money be made a function of the Federal government, exercised through a Federal Stabilization Board.
2. That the Stabilization Board shall have the power of creating new money, to be turned over to the Federal government to finance budget deficits and/or to pay off the Federal debt.
3. That the Government and the Board manage Federal finances in such a way as to create and issue new money any time that a depression threatens, so as to directly and indirectly stimulate industry and maintain full employment.

WHY IS THE FULL EMPLOYMENT STANDARD  
NECESSARY?

The following propositions summarize the case for the Full Employment Standard: 1. An expanding economy (the United States) can absorb immense amounts of new money without price inflation. 2. In an expanding economy (the United States) an irregular increase in the amount of money is necessary in order to achieve and maintain prosperity and full employment. 3. The present American monetary system (the Gold and Banking Standard) is unlikely to produce this continual increase in the amount of money, and may even produce disastrous decreases.

*Therefore*, a new monetary system, the Full Employment Standard, which will produce the right increases of money at the right times, is necessary.

These propositions are somewhat unusual, and definitely vital. They call, therefore, for careful exposition and discussion. Let us take up each one individually. The first two will be discussed in this chapter, the third in the next chapter.

AN EXPANDING ECONOMY (THE UNITED STATES) CAN  
ABSORB IMMENSE AMOUNTS OF NEW MONEY  
WITHOUT PRICE INFLATION

The basic facts supporting this proposition are presented in Table 4—Economic Progress of the United States, 1800–1940—and presented graphically in the correlative chart (Chart I).

The story told by these facts is plain and clear, and can be summarized in a very few words. In the year 1800



CHART I—ECONOMIC PROGRESS OF THE UNITED STATES, 1800-1940-1980

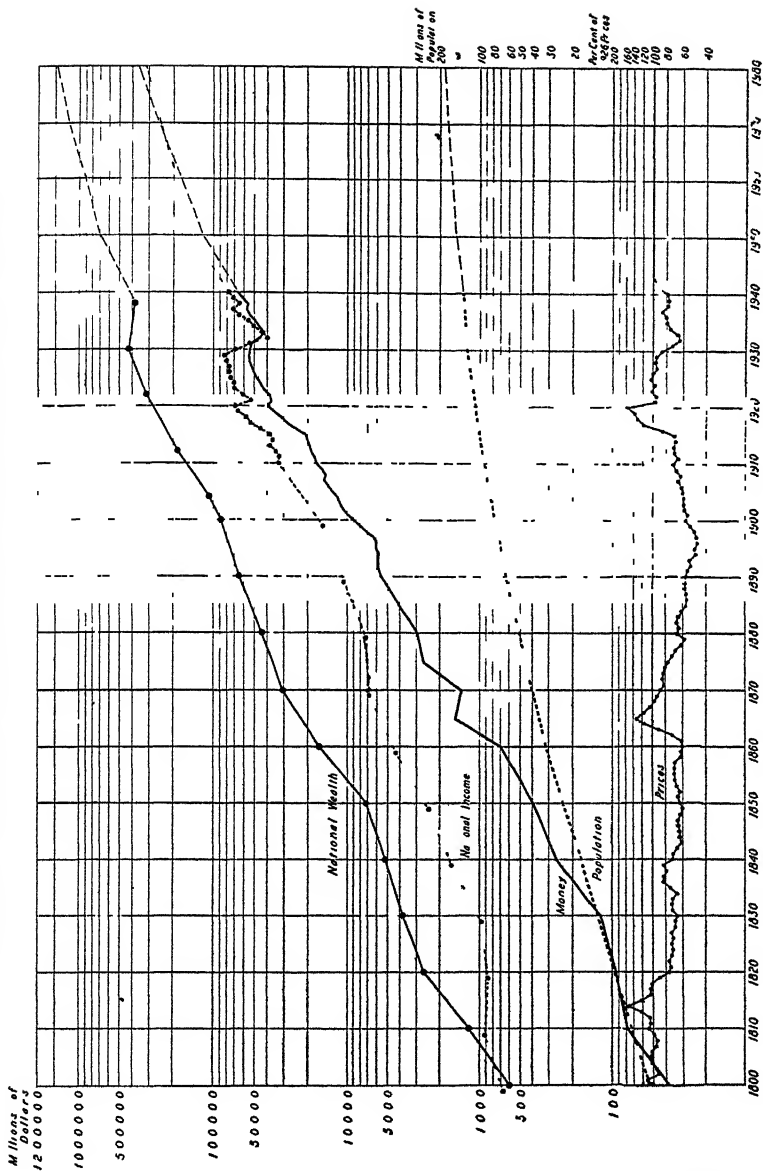


TABLE 4—ECONOMIC PROGRESS OF THE UNITED STATES, 1900-1940

Year	Population <sup>a</sup> (Millions)	Money in Circulation <sup>b</sup> (Millions)	Bank Deposits <sup>c</sup> (Millions)	Total Money <sup>d</sup> (Millions)	Prices <sup>e</sup> (1936=100)	National Wealth <sup>f</sup> (Billions)	National Income <sup>g</sup> (Billions)	Money per Capita	Wealth per Capita	Income per Capita
Decennial figures										
1800	5.3	\$ 27	\$ 11	\$ 38	101.6	\$ 6	\$ 7	\$ 7	\$ 113	\$131
1810	7.2	55	22	77	107.7	12	9	10	107	130
1820	9.6	87	27	94	106.6	20	9	10	211	171
1830	12.9	87	55	142	76.6	38	10	10	207	78
1840	17.1	180	76	202	71.1	52	16	15	304	98
1850	23.3	279	110	389	62.3	71	24	17	305	107
1860	31.5	435	254	689	60.9	102	43	22	514	140
Quinquennial figures										
1865	35.7	1,084	458	1,542	132.0	301	68	43	754	173
1870	39.9	775	598	1,373	86.7	301	68	34	754	173
1875	43.1	834	1,787	2,621	77.7	43.6	72	58	867	147
1880	50.3	973	1,952	2,925	65.1	43.6	72	58	867	147
1885	56.7	1,293	2,734	4,027	50.6	65.0	107	87	1,030	173
1890	63.1	1,429	4,074	5,503	56.2	65.0	107	87	1,030	173
Annual figures										
1892	65.7	1,015	4,823	5,838	52.2	89	89	89	88	88
1893	67.0	1,081	4,787	5,868	53.4	88	88	88	88	88
1894	68.3	972	4,815	5,787	47.9	85	85	85	85	85
1895	69.6	971	5,061	6,032	48.8	87	87	87	87	87
1896	70.9	974	5,074	6,048	46.5	85	85	85	85	85
1897	72.2	1,013	5,102	6,205	46.6	86	86	86	86	86
1898	73.5	1,150	5,882	7,032	48.5	15.4	15.4	107	1,163	205
1899	74.8	1,181	6,355	7,536	52.2	88.5	16.2	116	1,163	212
1900	76.1	1,331	7,534	8,865	56.1	88.5	16.2	116	1,163	212
1901	77.6	1,395	8,078	9,473	57.3	107.1	16.2	129	1,163	212
1902	79.2	1,431	9,468	10,899	58.9	107.1	16.2	137	1,163	212
1903	80.6	1,543	9,999	11,542	59.6	107.1	16.2	143	1,163	212
1904	82.2	1,562	10,411	11,973	59.7	107.1	16.2	146	1,163	212
1905	83.8	1,620	11,668	13,287	60.1	107.1	16.2	158	1,163	212
1906	85.4	1,759	12,302	14,121	61.8	107.1	16.2	165	1,163	212
1907	87.0	1,700	13,462	15,162	65.2	107.1	16.2	174	1,163	212
1908	88.7	1,711	13,007	14,718	62.9	107.1	16.2	160	1,163	212
1909	90.5	1,691	14,103	15,794	67.6	107.1	16.2	175	1,163	212
1910	92.4	1,725	15,252	16,977	70.4	107.1	16.2	184	1,163	212
1911	93.9	1,709	16,053	17,762	64.9	107.1	16.2	189	1,163	212
1912	95.3	1,762	17,103	18,865	69.1	107.1	16.2	198	1,163	212
1913	97.2	1,858	17,545	19,403	69.8	107.1	16.2	200	1,163	212
1914	99.1	1,533	18,498	20,031	68.1	107.1	16.2	202	1,163	212

1915	1,575	19,107	20,682	60 5	38 3	266	381
1916	1,876	22,325	24,201	85 5	44 9	237	440
1917	2,276	25,878	28,154	117 5	53 4	273	517
1918	3,208	28,125	31,423	131 3	58 1	304	563
1919	3,593	34,012	35,605	138 6	66 1	341	633
1920	4,105	35,754	39,859	154 4	60 8	374	655
1921	3,677	34,114	37,791	97 6	58 8	348	487
1922	3,346	35,052	38,968	96 7	56 6	334	550
1923	3,739	39,007	42,746	100 6	70 0	382	626
1924	3,650	40,860	44,510	98 1	70 1	390	614
1925	44,750	48,323	103 5	103 5	74 8	417	646
1926	3,602	46,069	50,570	100 0	70 0	431	655
1927	3,536	45,073	52,710	95 4	76 4	430	642
1928	3,622	51,050	54,678	96 7	80 2	454	666
1929	3,639	51,532	55,171	95 3	83 4	453	685
1930	3,669	51,020	54,389	86 4	428 1	442	561
1931	3,651	49,232	52,883	73 0	54 3	426	438
1932	4,616	49,790	45,415	64 8	40 0	364	321
1933	4,761	36,010	41,680	65 9	42 5	332	338
1934	4,659	41,302	45,961	74 9	50 3	364	398
1935	4,783	45,098	49,881	80 0	55 8	392	438
1936	5,222	49,830	55,052	86 8	65 1	430	508
1937	5,489	51,769	57,258	86 3	71 4	445	554
1938	5,417	51,148	56,505	78 6	64 4	430	490
1939	6,005	54,938	60,043	77 1	70 8	466	541
1940	6,690	60,253	66,052	78 6	77 3	507	586

<sup>a</sup> *Statistical Abstract of the United States, 1942*, p. 2, for the years 1800 to 1840, for later years, the figures are the annual (July 1) estimates, *ibid.*, p. 11.

<sup>b</sup> The figures for 1800 to 1890, *Statistical Abstract of the United States, 1942*, p. 277. The figures from 1892 to 1940, Federal Reserve Banking and Monetary Statistics, pp. 34 and 35. The Federal Reserve figures are for currency outside banks.

<sup>c</sup> The figures for bank deposits, excluding interbank balances and U. S. deposits, 1840 to 1890, *Statistical Abstract of the United States, 1942*, p. 291. The figures for 1800 to 1830 are the writer's estimates, based on the ratios between deposits and circulation in 1840 and 1890. The figures from 1892 are the adjusted deposits figures, Federal Reserve Banking and Monetary Statistics, pp. 34 and 35.

<sup>d</sup> Totals of the two preceding columns. The figures from 1892 are "Total deposits adjusted and currency outside banks," Federal Reserve Banking and Monetary Statistics, pp. 34 and 35.

<sup>e</sup> For the years 1890 to 1940, *Statistical Abstract of the United States, 1942*, p. 372. For the years 1800 to 1885, U. S. Bureau of Labor Statistics, Bulletin No. 543, *Wholesale Prices 1930*, p. 39.

<sup>f</sup> The figures for 1850 to 1922 are the official governmental estimates, *Statistical Abstract of the United States, 1922*, p. 646. The figures for earlier and later years are those given by Robert R. Doane, *The Anatomy of American Wealth*, p. 26.

<sup>g</sup> The figures for 1800 to 1900 (actually, decennially, 1799 to 1899) are from Robert F. Martin, *National Income in the United States, 1799-1938* (New York: National Industrial Conference Board [1939]), p. 6. It is the present writer's opinion that the figures for 1799 to 1810 are too high — by at least 100 per cent in 1799. The figures from 1910 on are those of the U. S. Department of Agriculture, "Net Farm Income and Income Parity Summary, 1910-42."

the total amount of money in the United States was about \$38,000,000. In the year 1940, the amount of money was \$66,952,000,000. The quantity of money was 1,762 times as large in 1940 as it had been in 1800.

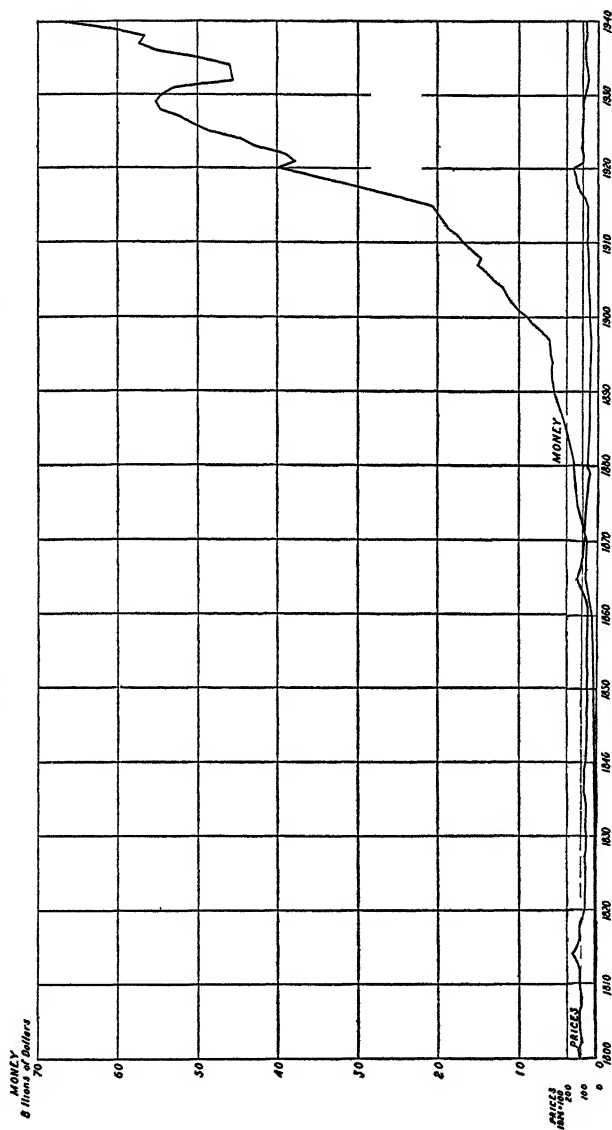
And what happened to prices in this 140-year period? Did prices soar, as the quantity of money rose so enormously? No; whereas in 1800 the price index was 101.6, in 1940 it was lower—78.6.

An excessively naive quantity theory of money would suggest that if the amount of money increased to 1,762 times, so would the price level. That is, if the price index for 1800 had been 100, by 1940 it would have been about 176,200. Actually, if the price index had been set so that it was 100 in 1800, the 1940 figure would have been 77.4. On (Chart II) the arithmetic scale chart, the price scale has really been exaggerated, in order to show the intermediate price fluctuations. That is to say, if the price line and the money line had started at the same point in 1800, the fluctuations in the price line would have been almost invisible. The facts, then, are clear. Despite an enormous increase in the amount of money in the United States, the price level, over the 140-year period has been horizontal.

As a matter of fact, it is likely that, in the broadest sense, commodity prices have actually gone down over this long period. The explanation of this claim is a three-fold one:

(1) Many important commodities (especially finished goods) are not included in the price indexes because they are not "standardized"; i.e., their quality, content, or specifications change from time to time. Examples are radio sets, washing machines, and automobiles.

CHART II—MONEY AND PRICES, U. S. A., 1800-1940



(2) The typical price behavior of such goods is that their prices gradually decline as production techniques are improved and quantity output is achieved.

(3) Coincidentally, there is typically an improvement in quality which is substantially equivalent to a reduction in price. Automobile tires are an example familiar to all. They cost, in 1940, one-fourth what they did twenty-five years before and ran four times as far. That is really the equivalent of a reduction of the price to one-sixteenth of the original price!

#### WHAT IS THE EXPLANATION?

This tremendous disparity between the 140-year trend of the quantity of money and the price level calls for explanation. The explanation is really simple: The United States is an *expanding* economy. The population is growing, and potential per capita production increases rapidly. These two factors are multiplicative and, together with the greater wealth and income that they create, explain why an expanding economy needs more money and can absorb it without price inflation.

The relation of these key factors—population, wealth, and income—to money and prices is entitled to some further consideration.

#### *Population and Money*

One explanation of the disparity between the change in the country's money supply and the level of prices is the increase in the population. As the large table and chart show in detail, the population rose from 5.3 million in 1800 to 132 million in 1940. That means that in 1940 there were about twenty-five times as many trouser

pockets that needed some money. When there are more people who want to use and hold money, a proportionate increase in the total amount of money is not incompatible with a stationary price level.

Actually, the total amount of money increased much faster than the population, so that the per capita amount of money rose markedly. As the figures on the large table show, the amount of money per capita increased fairly steadily from \$7 per capita in 1800 to \$507 in 1940—an increase to seventy-two times the earlier figure. The explanation of why this large increase in the per capita amount of money did not lead to a price rise will be found in the figures for wealth and income, to which attention will be given presently.

### *The Future: Population and Money*

In order to get some idea of the amounts of money that the United States will need in the postwar decades let us make a projection of the population figures and the per capita money figures.

Table 5 presents the present writer's estimates of the future population of the United States for the next few decades. The figures run higher than do many other writers' estimates. I believe that the low estimates are too greatly affected by the figures of the decade of the Dismal Thirties, and too little affected by the broader notion which both earlier and later history suggest, namely, that when jobs are plentiful and pay is good, people get married and have children. My population forecasts are based on the assumption of prosperity—they represent the probable future growth of American population if times are good. If, of course, postwar America relapses

into its prewar perpetual slump, the population would increase to only about 150 million by 1960, and then would *start to decline*.

Since, however, the theme of this book is how to make America prosperous and keep it that way, we need to consider how much money a growing, vigorous, happy population would like to have on hand. Table 5 presents these estimates. The estimates are based on a postwar price level indicated by a wholesale price index of 100.

TABLE 5  
ESTIMATED POPULATION AND MONEY, 1950-1980

Year	Estimated Population	Money per Capita	Total Money Needed (Billions)
1950 .....	148,000,000	\$ 800	\$118
1960 .....	161,000,000	1,120	180
1970 .....	173,000,000	1,570	272
1980 .... .	182,000,000	2,200	400

This price level is not assumed because the figure "100" is believed to represent "normal." It is taken because it was about the level of prices in the 1920's, before the Great Depression; and is about the level to which prices have risen during the present war. By 1944, the wholesale price index had risen to 104.3.

I see no good reason for deliberately aiming at a lower price level. A higher price level (and income level) would reduce the burden of the war debt.

A higher price level would require larger amounts of money. I believe that a postwar price level of 110 is, as a matter of fact, more likely than one of 100. If so, the amounts of money needed in the future would be increased by 10 per cent above the calculations which are



presented here. Since, however, these calculated amounts are likely to seem enormous; and since I should prefer the estimates to be conservative, they remain based on a price level of 100.

TABLE 6

THE QUANTITY OF MONEY COMPARED WITH NATIONAL WEALTH

Year	Money ( <i>Millions</i> )	National Wealth ( <i>Millions</i> )	Money as a Percentage of National Wealth
1800 . . . . .	\$ 38	\$ 620	6.13%
1810 . . . . .	77	1,217	6.33
1820 . . . . .	94	2,588	3.63
1830 . . . . .	122	3,825	3.19
1840 . . . . .	262	5,226	5.01
1850 . . . . .	389	7,136	5.46
1860 . . . . .	689	16,160	4.26
1870 . . . . .	1,373	30,069	4.57
1880 . . . . .	2,925	43,642	6.70
1890 . . . . .	5,503	65,037	8.46
1900 . . . . .	8,865	88,517	10.02
1904 . . . . .	11,973	107,104	11.18
1912 . . . . .	18,865	186,300	10.13
1922 . . . . .	38,998	320,804	12.16
1930 . . . . .	54,389	428,126	12.70
1938 . . . . .	56,565	388,421	14.56

The estimates also take account of the historical growth in the amount of money per capita; and project these increases into the future.

## WEALTH AND MONEY

A second factor which helps to explain why prices have not risen as the quantity of money has increased is the immense growth in the national wealth of the United States. Table 6 brings together these figures, and shows that the amount of money has grown faster than the na-

tional wealth, so that the percentage which money is of national wealth has grown fairly steadily.

Table 4 shows the increase in per capita wealth—from \$113 in 1800 to \$2,992 in 1938.

These figures show what is indeed entirely reasonable, namely, that as people get richer they are disposed to hold an increasing amount of cash. They have bigger and better houses, better and more clothing, more automobiles, more investments, and are quite willing to have more money also.

The figures also show that there has been a gradual tendency for money to become a slightly larger percentage of the total national wealth. Is this not reasonable? As people get richer they can better afford to have some of their wealth in the form of money. At the same time there has developed a decreasing use of barter and an increasing use of money as a method of exchanging goods. If, then, we wish to look forward to a continually rising national wealth in future decades, it is reasonable to expect that the total amount of money should increase even faster.

### *The Future: National Wealth and Money*

Now let the figures for national wealth be projected into the future, together with the percentages of money to national wealth, both being calculated at the historical growth rates. Multiplying these figures then gives us figures for the appropriate supply of money (Table 7).

### *National Income and Money*

Another factor helping to explain why prices have remained horizontal through the 140-year period, despite

the great increase in the quantity<sup>1</sup> of money, is the immense growth of the national income. In 1799 the annual national income was 677 million,<sup>2</sup> or \$131 per person. In 1940 the national income had risen to 77.3 billion, or

TABLE 7  
ESTIMATED NATIONAL WEALTH AND MONEY, 1950-1980

Year	National Wealth (Billions)	Money as a Percentage of National Wealth	Total Money Needed (Billions)
1950 . . . . .	\$ 700	16.1%	\$120
1960 . . . . .	910	18.1	165
1970 . . . . .	1,180	20.5	242
1980 . . . . .	1,452	23.1	335

\$586 per capita. The underlying causes of this increase in per capita income have been capital growth, technological improvement, and better trained labor; so that per capita productivity has gone up, despite halving the number of hours worked per week by the average worker.

This increase in production and income has a twofold impact on the need for, desire for, and ability to hold money. In the first place, the stream of goods has risen steadily. This means that, unless monetary velocity rises, more money is needed in order to transact business. In the second place, as people's incomes rise, their money position becomes less "hand-to-mouth"—they can afford to hold some cash, since they no longer need to spend their few dollars as fast as they are received.

As incomes have grown, the percentage of money to incomes has increased steadily, as shown in Table 8.

TABLE 8

THE QUANTITY OF MONEY COMPARED WITH THE NATIONAL  
• INCOME

Year	Money (Millions)	National Income (Millions)	Money as a Percentage of National Income
1800 . . . \$	38	\$ 677	5.67%
1810 . . . .	77	915	8.42
1820 . . . .	94	876	10.73
1830 . . . .	122	975	12.51
1840 . . . .	262	1,631	16.06
1850 . . . .	389	2,420	16.07
1860 . . . .	689	4,311	15.98
1870 . . . .	1,373	6,827	20.11
1880 . . . .	2,925	7,227	40.47
1890 . . . .	5,503	10,701	51.43
1900 . . . .	8,865	16,158	54.86
1910 . . . .	16,977	33,064	51.35
1915 . . . .	20,682	38,254	54.06
1920 . . . .	39,859	73,393	54.31
1925 . . . .	48,323	75,187	64.27
1929 . . . .	55,171	85,954	64.19
1930 . . . .	54,389	75,364	72.17
1935 . . . .	49,881	56,398	88.44
1940 . . . .	66,952	78,481	85.31

### *The Future: National Income and Money*

Once again (Table 9), we may project the estimates for national income and the percentages which money is likely to bear to income, to see what estimates we get of the total amounts of money that the American economy will need.

#### THE AMOUNTS OF MONEY NEEDED IN THE FUTURE

In the foregoing discussion an analysis has been developed, in terms both of reasoning and statistics, to

explain why the increase of the amount of money in the United States from \$38,000,000 to \$66,952,000,000 in 140 years was accompanied by an approximately horizontal price level.

TABLE 9

ESTIMATED NATIONAL INCOME AND MONEY, 1950-1980

Year	National Income ( <i>Billions</i> )	Money as a Percentage of National Income	Total Money Needed ( <i>Billions</i> )
1950 .....	\$144	82%	\$118
1960 .....	188	92	173
1970 .....	246	102	251
1980 .....	315	112	353

As economists will recognize, the analysis has been a lay language presentation which corresponds to those equational descriptions of the quantity theory which stress the amount of command over goods which people are disposed to want to have in the form of money, corresponding to given magnitudes of wealth and income—sometimes described as the “Cambridge type” of quantity equations.

But, whatever the language, the facts are clear: over a period of 140 years the United States absorbed large and increasing amounts of money without price inflation because the population grew, and the average person's wealth and income rose, causing him to want to hold more money.

As has been true, then, in the past, so we may expect in the future, that if the quantity of money is increased at a rate appropriate to the country's ability to absorb cash, price inflation will not occur. Estimates of these appropriate rates and amounts have been made on the

basis of population, of wealth, and of income. These estimates may now be brought together and averaged (Table 10), to give an approximate notion of the amounts of money that the expanding American economy could absorb between the present and the year 1980, without price inflation.

TABLE 10  
ESTIMATES OF THE AMOUNT OF MONEY NEEDED BY THE AMERICAN  
ECONOMY, 1950-1980  
(All money figures in billions)

Year	Based on Population	Based on National Wealth	Based on National Income	Rounded Average of these Estimates	Additional Money Needed During the Decade
1950 .....	\$118	\$120	\$118	\$119	
1960 .....	180	165	173	173	\$ 54
1970 .....	272	242	251	255	82
1980 .....	400	335	353	363	108

*More Money is Necessary for Full Employment*

We may now turn our attention to the second proposition that supports the need for the Full Employment Standard—that in an expanding economy (the United States) an irregular increase in the amount of money is necessary in order to achieve and maintain prosperity and full employment.

Presentation of this proposition starts with an analysis of the nature and past operation of the American monetary system, as part of a dynamic expanding economy, to see why and when it worked well, and why

and when it worked badly, handicapping the entire American economy.

During most of the 140-year period, from 1800 to 1940, the United States was on the "gold standard." It is important to note that the term meant that all kinds of money were legally convertible, directly or indirectly, into gold. It did not mean that the quantity of money was determined solely by gold increments or decrements. Gold increments plus bank credit increments (or decrements) controlled the total quantity of money. Therefore, so far as the word "standard" connotes *the factor that controls the total quantity* of a country's money, the United States might more aptly be described as being on a "Gold and Bank Credit Standard." (The relatively small amounts that have been contributed by silver and by government notes do not deserve equal rank.)

Specifically, in 1940, there was \$66,952,000,000 in money in the United States. Where did this money come from? Some of it, about 20 billion dollars, came from gold. About 2.5 billion came from silver and the uncovered part of the Greenbacks. The remainder, about 44.5 billion, came from bank credit.

In other words, some new money was created and handed over partly in exchange for gold. Other new money was created by the banking system, in exchange for the promises to repay of the borrowing individuals and corporations. The newly created bank money was convertible into paper money, and that into gold. In addition, the newly created bank money usually had capital goods behind it. A minor fraction of bank loans, to be sure, are made to impecunious persons, natural and corporate. Most bank loans, however, provide new money

to pay for capital goods, and thus it may be said that new bank money is issued either in exchange for gold, or for industrial, commercial, or personal capital goods.

It is important to note that there was no system for controlling the total quantity, for regulating the additions to or subtractions from the quantity of money. The job was left to the operations of gold and banking.

Nevertheless, owing largely to certain lucky accidents, the money-creating system worked fairly well until 1929. American economic history since 1800, as shown in Table 4 and Chart I, shows that the total amount of money expanded during this long period at a fairly satisfactory and very large rate until 1929. In 1800 there was about \$38,000,000 total cash in the little country. By 1929 that figure had grown to \$55,171,000,000—an increase of *more than fourteen hundred times*. To be sure, the growth was not always at the *right rate*. Under the stress of war, *too much* money was added between 1860 and 1865; and again between 1915 and 1919. Even in these instances, however, the country soon “grew up to the currency.”

Throughout this long period, from 1800 to 1929, the rapidly growing American economy was nourished and stimulated by this somewhat irregular and definitely enormous increase in the quantity of money. The population rose from 5,308,000 to nearly 121,800,000. Production grew even faster—the production index rose at least one hundred times.

Up to 1929, then, the American monetary system, largely by accident, produced increasing amounts of money. It did so somewhat irregularly to be sure, and often with bad timing, but it did feed more and more



lubricating oil into the crankcase of the enormously expanding American economic engine.

That the monetary system was able to keep on producing larger sums of money during all these decades was due to several lucky accidents which came along just in time to rescue the Gold and Bank Credit Standard.

The gold discoveries of 1849 in California rescued the system at that time. By 1849, prices were less than half what they had been during the War of 1812. Except for an upturn in 1834-1837, the trend was almost continuously downward during those decades.

The Greenbacks gave some monetary stimulus in the 1860's—too much, indeed, for three years. Then the country “grew up” to them; and prices declined until 1896, when Bryan first ran for President.

Bryan probably would have been elected in 1900, but the gold system had been rescued by then by a combination of events: (1) the gold discoveries in the Klondike and South Africa; and (2) the development of the cyanide precipitation process, which enabled profitable extraction of gold from low content ores. The world's gold production nearly doubled during those years, and prices stopped falling and started to rise.

The Federal Reserve System after 1914 provided a streamlined method for increasing the multiple of bank credit that could safely be piled on gold. This expansive possibility was used immediately in financing World War I, and accomplished a large increase in the country's money supply.

Thus, until 1929, the money-supplying system worked fairly well. *That this good fortune had been purely accidental, however, was made clear during the years that*

*followed.* For no good reason, but simply because the machine could run backwards as well as forwards, and because there was no control mechanism to regulate either its direction or its speed, the machine first slowed down its production of new money and then went into reverse, and began to rapidly reduce the amount of money. By 1933 the amount of money had shrunk to \$41,680,000,000—a decline of \$13,491,000,000. In short, a growing-boy economy that typically needed *more* monetary blood each year was being drained of money! And we all know what happened. Our country experienced a terrible depression, from whose dulling effects we have not yet recovered.

The appalling impact of the Great Depression could have been avoided if the men thrown out of work could have received unemployment benefit payments or been employed on public works, financed by newly created money. The sustained spending by these men would have prevented cumulative loss of jobs by others; and the newly created money eventually would have found its way into the pockets and bank accounts of people who wanted to *save*, but did not want to *invest*. In this way and in this way only, can a widespread desire to save-without-investing, which is the basic cause of depression, be satisfied *without* widespread unemployment.

MONEY, SPENDING, PRICES, PRODUCTION,  
AND EMPLOYMENT

The figures presented above support the proposition which indeed appeals to one's common sense, that if in an expanding economy the amount of money is contracted, the results are likely to be adverse. Let us now take a

look at the basic relations between the amount of money, on the one hand, and spending, prices, production, and unemployment on the other.

Readers who are familiar with the literature of monetary theory will recognize that the following explanation runs in terms very much like those in which Marshall, Pigou, and Keynes (though differing in details) approached the analysis of the relation of the quantity of money to prices. The common thread in these analyses is that each person, at any moment, considers a certain quantity of money to be satisfactory, considering the relevant circumstances, e.g., his wealth, his income, and his expenditures. These experts differ as to what are the relevant circumstances, but the basic idea continues into this further expression: If a person finds that the *actual* quantity of money he has *exceeds* the *desired* quantity, he takes steps to get rid of some of the money. Conversely, if the *actual* quantity is *smaller* than the *desired* quantity, he does what he can to increase his stock of money, e.g., he reduces his money outlays. If people *generally and predominantly* find that they have an excess of money, their efforts to get rid of it will generate a rise in prices and incomes and wealth. Conversely, if people *generally and predominantly* hold less money than they want, their efforts to lay out less than they receive will generate a decline in spending, prices, employment, incomes, and wealth.

The total amount of money is not fixed by the people generally; it is fixed by the monetary apparatus (which may mean gold mining and banking). Since the people cannot alter the total quantity of money, what their actions do alter is the magnitude of the other factors which

are related, in their minds, to the magnitude of the desired quantity of money. This process is presumably more or less continuous, so that the various magnitudes (prices, employment, income, wealth, and others) get altered continuously, with only occasional "jerky" adjustments.

This explanation of changes in prices, incomes, and wealth is wholly apart from and in addition to the *direct* effect of changes in the quantity of money (via gold mining or banking). An increase in gold mining or an increase in bank loans means that more money is immediately being paid out as income; and that wealth and prices are being directly affected. Conversely, a decrease in either of these factors is accompanied at first hand by a decrease in prices, employment, incomes, and wealth.

HOW A STATIONARY QUANTITY OF MONEY AFFECTS  
SPENDING, PRICES, PRODUCTION, AND EMPLOY-  
MENT IN AN EXPANDING ECONOMY

In an expanding economy, if the amount of money remains stationary, the demand for goods is chronically smaller than the potential supply, with the result that unemployment and declining prices are chronic, and the economy is exceptionally sensitive to any adverse factors that might cause a serious depression. If the amount of money is not merely stationary, but actually declining, the situation is worse. Contrariwise, an expanding amount of money goes along with increases in spending, production, and per capita incomes, but no rise in prices.

The retarding effect of a stationary amount of money in an expanding economy can be seen by some very sim-

ple steps of analysis. For example, suppose that in an expanding economy—

- (1) The amount of money is stationary;
- (2) The potential real national income is doubled;
- (3) The people are disposed to hold a quantity of money whose real purchasing power is equal to a given percentage of their real annual national income (say 80 per cent).

The only way in which the potential doubled real national income could be realized would be by a general reduction in the prices of goods by 50 per cent. The alternative would be for enough unemployment to be generated to reduce the real national income sufficiently below its potential maximum, so that it is just about 1.25 times the stationary quantity of money. In other words, the money value of the national income will remain stationary, as long as the amount of money is stationary.

Since the sellers of goods are reluctant to reduce the prices of their goods, the necessary price reduction might be too slow in coming. Furthermore, the business community would not view with enthusiasm an economic world in which prices were to go down steadily, being halved every twenty years. Investment in long-lived plant and machinery would not be encouraged.

The effects of a stationary quantity of money in an expanding economy would be the same as the results of a decreasing quantity of money in a stationary economy. The latter case may represent a simpler example. If in a stationary economy the quantity of money were continually decreased, spending would decline, prices would go down, and unemployment would be chronic.

In either case (the stationary economy with decreasing money, or the expanding economy with stationary money) the situation would be the same; the *goods stream* would continually be pressing against the *money stream*; the money stream would always be a little too small to carry off the potential goods stream. Therefore prices would fall continually, and unemployment would be continuous.

The ideal situation is just the opposite: to have the money stream continually exerting a mild *suction* on the goods stream, so that the monetary demand is always large enough to easily buy all the goods that the economic machine can produce.

In an expanding economy this happy condition can be realized only if the amount of money is increased at an appropriate rate. If it is increased too rapidly, price inflation occurs; if too slowly, we get price deflation, chronic unemployment, and peculiar sensitivity to periodic depressions.

#### THE MONETARY SITUATION IMMEDIATELY AFTER THE WAR

For a few years after the war, the United States will probably be in the unusual position of having *more* money than is needed to accommodate the secular growth need of the country.<sup>1</sup> The cause is the current war deficit financing.

In 1940 the country did not have enough money. The amount in existence at that time—67 billion dollars—was

<sup>1</sup> More than enough, that is, at a price level about equal to that of 1926 or 1944, typified by a wholesale price index of 100. If the price level should be higher, the required amount of money would be increased, and the excess decreased correspondingly.

about 20 per cent smaller than the right amount for 1940. As the defense program grew, and the war activity increased, the financing used by the Federal government caused the amount of money to shoot up rapidly. The government financed a large part of its budget deficit by the sale of notes, certificates, and bonds to the banks. Between 1940 and 1944 American banks' holdings of gov-

TABLE 11  
MONEY IN THE UNITED STATES, 1940-1944  
(*In billions of dollars*)

June	Total Money	United States Government Deposits	Total Money Adjusted
1940 .....	\$ 67.0	\$ .8	\$ 67.0
1941 .....	74.2	.8	74.2
1942 ... ..	82.0	1.8	81.2
1943 ..... ..	110.2	8.0	102.2
1944 .....	136.2	19.5	117.7

NOTE: "Total Money Adjusted" equals Total Money minus the amount by which the government's deposits exceed 1 billion dollars.

ernment securities rose from 19.7 billions to 75.7 billions—an increase of 56.0 billions. This expansion of bank credit was the predominant factor affecting the quantity of money during that period. As Table 11 shows, the total amount of money rose 59.2 billions in that time.

The table also shows that the government borrowed more money than was necessary to finance its budget deficits. The government borrowed so much money that its cash rose from .8 billion dollars to 19.5 billions. This great increase in the Treasury's cash was presumably justified, as a temporary wartime safety measure. In

peacetime, however, 1 billion dollars would surely be enough, and any excess could be used to retire debt. In other words the government's cash, if above 1 billion is wartime contingency money, and would disappear in debt repayment in peacetime. Therefore, the column headed "Total Money Adjusted" shows more accurately the amount of money that is really available for spending.

Thinking, then, of this amount of money, we note that it rose 40.7 billion dollars in four years. From a strictly *economic* viewpoint, that was too large an increase. It produced full employment and prosperity, to be sure; but it generated too much spending and too large incomes. Had it not been for wartime price controls, bond purchases, and other exceptional saving, the prices of the restricted quantity of civilian goods would have risen much more than they did. The quantity of government spending and concomitant money creation was not controlled by purely economic considerations but rather by political and military considerations.

This war-induced increase in the nation's money supply represented an undesigned and unscientific making up of a monetary shortage. Thanks to war finance, the quantity of money was built up by 1943 to approximately the amount required for the long-time economic expansion of the United States. For the first time since 1929 the country possessed enough money—indeed, as the war continued, more than enough.

The money supply was still going up in 1943 and 1944; and would continue to rise during the period of large-scale military expenditure. It is not possible to make a precise prediction of the amount of money that there will



be in 1946, when military expenditure drops to a modest level, since the size of the deficit and the method of financing it cannot be forecast with precision. Tables 12 and 13 show some of the relevant data for fiscal years through June 1944, and give some guide to what might be expected in 1945 and 1946.

TABLE 12  
EXPANSION OF BANK HOLDINGS OF GOVERNMENT SECURITIES,  
1941-1944

Year ending June	Treasury Deficit	Increase in Bank Holdings of Govern- ment Securities	Per Cent of Deficit
	<i>(In billions of dollars)</i>		
1942 .....	\$19.6	\$ 6.8	34.7%
1943 .....	55.9	27.4	49.0
1944 .....	49.6	18.0	36.3

The table reflects the rise in tax revenues, which reduced the deficit. It also shows that efforts to sell bonds to non-banking buyers were more successful. Indeed, if allowance is made for the increases in Treasury cash holdings, the result is even more favorable. That is, deduct from the increases in bank holdings of government securities the increases in the government's cash. This deduction represents the elimination of extra-budgetary borrowing—borrowing which was more than enough to meet the deficits, and piled up cash in the hands of the government. Let the adjusted amounts be called "Adjusted Increase in Bank Holdings of Government Securities."

The adjusted picture is shown in Table 13.

Even with these tables before us, no precise forecast can be made of the monetary position of the United States in 1946. Preliminary figures for the fiscal year 1945 sug-

TABLE 13  
ADJUSTED INCREASE IN BANK HOLDINGS OF GOVERNMENT  
SECURITIES, 1941-1944

Year ending	Treasury Deficit	Adjusted Increase in Bank Holdings	Per Cent of Deficit
June			
1942 .....	\$19.6	\$ 5.8	29.6%
1943 ... ..	55.9	21.2	37.2
1944 .....	49.6	6.5	13.1

gest that the banks were again absorbing larger amounts of bonds than before. A rough estimate, therefore, would suggest that the amount of money in the United States at the end of the period of heavy military expenditure would be about 135 billion dollars. Such an amount would be slightly more than enough for 1946.

The amounts of money needed by the American economy in the near future decades, as calculated in the preceding section, are:

In 1950 \$119,000,000

In 1960 173,000,000

In 1970 255,000,000

In 1980 363,000,000<sup>2</sup>

If the figure for 1950—119 billion dollars—is about

<sup>2</sup> These estimates, it will be remembered, are based on a price level represented by an index number of about 100. If the price level should in fact turn out to be about 110 or 115, which is not unlikely, the monetary needs would increase correspondingly.

right, and if the war's end should find the actual amount of money to be 135 billions, the country would be slightly oversupplied with money. That amount—135 billions—would be about right for 1955; and the country might be expected to “grow up to the currency” by that time.

It is unlikely, however, that the amount of money in the country would stand still after the end of the war, until the country's growth caught up with it. On the one hand, a reduction might be necessary, should post-war business be so vigorous as to threaten an inflationary boom. On the other hand, a slower-than-secular rate of expansion might be appropriate while the amount exceeded the secular needs.

In either case the country would grow up to either a reduced quantity (say 125 billions), or to an increased amount (say 145 billions) some time in the decade of the 1950's. Thereafter substantial increments would be necessary.

## CHAPTER 4

# The Operation of the Full Employment Standard

WE COME NOW to the third proposition given at the beginning of the preceding chapter: That the present American monetary system is unlikely to produce the necessary increases in the amount of money, and may even produce disastrous decreases.

As the discussion in the preceding chapter has shown, up to 1929 the present monetary system, helped by some lucky accidents, did fairly well in producing more and more money. But the luck ran out in 1929, and unless there occur some more lucky accidents in the future, which is unlikely, the system will not produce enough money to maintain prosperity.

Under the present system, new money comes from gold and from bank credit. The gold part of the system has been "rescued" at least three times in the 140-year period. Table 14 shows how, at critical times, by historical accidents, gold production turned upward.

Throughout most of the first half of the nineteenth century, prices were declining. Then, after gold was discovered in California and Australia, annual world gold production increased ten times in fifteen years. This immense increase in gold production was an important factor in checking the downward price trend, and in turning prices upward. The upturn, complicated by the Civil War, did not last long, however. For thirty years, after 1865, prices were declining. During these decades, as the table shows, world gold production declined

slightly, as the richest ore veins in the new gold fields were exhausted.

Then, in the nineties, a combination of events caused gold production to shoot up again. Gold was discovered in South Africa and the Klondike, and the cyanide pre-

TABLE 14  
WORLD PRODUCTION OF GOLD, 1801-1939

Year	Average Annual Production ( <i>ounces</i> )	Average Annual Production ( <i>dollar value</i> )
1801 .....	572,000	\$ 11,823,000
1811 .....	368,000	7,607,000
1821 .....	457,000	9,446,000
1831 .....	652,000	13,477,000
1841 .....	1,761,000	36,400,000
1850-1859 .....	6,036,000	124,764,000
1860-1869 .....	6,097,000	126,025,000
1870-1879 .....	5,468,000	113,024,000
1880-1889 .....	5,141,000	106,264,000
1890-1899 .....	9,508,000	196,530,000
1900-1909 .....	17,318,000	357,963,000
1910-1919 .....	21,200,000	438,204,000
1920-1929 .....	18,138,000	374,912,000
1930-1934 .....	24,042,000	496,948,000
1935-1939 .....	35,504,000	1,242,640,000

cipitation process was perfected. As a result, gold production was tripled in fifteen years. Once again, prices stopped falling and started to rise.

Gold production continued at the new high level for about thirty years. Then the coming of the Great Depression again stimulated production; but the main reason for the threefold increase in the *dollar value* of gold production in the late thirties was the reduction in the gold content of the dollar, or, what is exactly the same thing,

the increase in the official price of gold from \$20.67 per ounce to \$35.00 an ounce. This not only caused every ounce of gold produced to represent  $1\frac{2}{3}$  times as many dollars, but also, by greatly increasing the profitability of gold mining, stimulated an increase in the number of ounces that were produced.

#### THE SIGNIFICANCE OF BANK HOLDINGS OF GOVERNMENT SECURITIES

There is another significant respect in which the creation of new money occurred in a way that calls for special notice. This was the expansion of bank credit by lending to the government.

In June 1940, American banks were holding \$51,633,-000,000 of loans and investments. Of this quantity, \$31,922,000,000 represented loans, discounts, and commercial investments. But—and this is significant—the remainder, \$19,711,000,000 was United States government securities. In other words, if the government at some earlier periods had not run a deficit and had not sold bonds to the banks (thereby creating money), the total amount of money in the United States in 1940 would have been nearly twenty billion dollars smaller than it was—or only about 47 billions.

In summary, therefore, Table 15 shows where the 67 billion dollars that the United States had in 1940 came from.

The extension of bank credit to the Federal government is a process that is something like the Full Employment Standard, in that it creates money and helps to keep the system going. It differs, however, in that the government has to pay interest on the money created by selling

bonds to the banks and presumably eventually has to repay the debt, both of which require higher taxes.

This, however, is not the real point. The important thing is that the credit operations of banks that are ordinarily thought of as being their "proper" business—

TABLE 15  
SUMMARY OF SOURCES OF UNITED STATES MONEY IN 1940

	Billions	Percentage of Total
From gold . . . . .	\$20.0	29.8%
From silver and United States Notes . . . . .	2.5	3.7
From bank credit extended to individuals and corporations . . . . .	24.8	37.0
From bank credit extended to the United States government . . . . .	19.7	29.4
	<u>\$67.0</u>	<u>100.0%</u>

lending to individuals and to private commercial, industrial, and business concerns—plus gold mining, had not been large enough to produce the quantity of money that actually existed in 1940, by some twenty billion dollars. This fact reinforces the proposition that the operation of the Gold and Bank Credit Standard (in its normal business operations) is unlikely in the future to produce anywhere near the tremendous quantity of money that the American economy needs.

#### SUMMARY

These historical facts show clearly the fortuitous nature of the present American monetary system. They also show why the system is unlikely to produce enough money in the future. The past record is clearly not en-

couraging. In those years, when much new money was produced, it was largely the result of metallurgical accidents or dollar devaluation.

Will there be such metallurgical accidents in the future? Who knows? If there are such accidents, will they come at the right times, and produce sufficient quantities? Who knows? Since, however, the answers to all of these questions would have to be affirmative, it is pretty clear that gold metallurgy is far from reliable as a future money producer.

The other factor in the money-creation process, bank credit, has not produced sufficient money in the past, and has actually reduced the total amount of money after 1929. This kind of behavior of bank credit is perfectly natural and may be expected to recur in the future.

The conclusion is clear: the present Gold and Bank Credit Standard is unlikely to produce the large quantities of money that the American economy will need in the future.

Indeed, if the *gold* part of the standard were eliminated, it is obvious that the Bank Credit Standard would be even less adequate, since, as we saw above, the extension of Bank Credit to persons other than the Federal government had produced only 37 per cent of the nation's money supply. Because of what appears to be a downward trend in business borrowing from banks, the future percentage would be likely to be even smaller. If the Bank Credit Standard were to be merged with the Full Employment Standard, we might expect bank credit to supply about one-third of the needed money increments; and the other two-thirds would come from money created and disbursed by the Federal government.



## THE TECHNIQUE OF THE FULL EMPLOYMENT STANDARD

The three propositions which have been examined constitute the explanation of why the Full Employment Standard is necessary in order to maintain prosperity and full employment. Let us now turn our attention to how the proposed Standard would work.

Additions to the country's supply of money would be made by creating new money and distributing it through outlays by the Federal government at such rates as the Federal Stabilization Board found necessary to maintain full employment. It would be important that these increments to the country's money supply *not* be introduced in *steady* or *regularly rising* amounts. If this were done, it would mean that *too much* money would be introduced in some years, with a tendency toward pure price inflation. It would mean, furthermore, that *too little* money would be introduced in the depression years, thereby permitting unemployment. The basic rule would be simple: create new money whenever necessary to absorb cyclical unemployment; reduce the quantity of money or employ other restrictive controls when full employment prevails, and when spending is increasing unduly and prices are rising. The implementation of this rule would not be simple, and attention will be given later to the techniques involved.

The Federal budget would be in a condition of *secular unbalance*. It would not, however, and should not be unbalanced every year. At this point, a crucial difference between the Full Employment Standard and some current plans for Federal spending-to-give-employment should be noted. Apparently, certain proponents of gov-

ernmental spending view an indefinitely continuing increase in the Federal debt with indifference or at least as a necessity. The present plan takes a different view. *The Full Employment Standard does not contemplate an indefinitely rising Federal debt.* On the contrary, use of the Full Employment Standard would assist in paying off the huge war debt and reducing taxes. A domestic Federal debt is a burden and should be avoided. *What the country needs is not more debt, but more money!*

The technical apparatus for creating and paying out the money increments would be simple. The Board would create monetary certificates and deposit them in the Federal Reserve banks for the account of the United States Treasury. These amounts would be added to whatever deposit credit the Treasury had at the moment. The Treasury would not differentiate between the dollars thus added to its bank accounts and those obtained from any other source; but would merely draw checks in the usual fashion. Thus the increments to the money supply would be used to finance budget deficits. In other words, budget deficits would be financed, not by borrowing, but by newly created money.

#### BUDGET SURPLUSES AND DEFICITS

The magnitude of the budget deficits would depend, of course, on tax policy and the volume of expenditures. To a certain extent the budget deficit would rise or fall, or even change into a surplus, more or less automatically, without any special fiscal actions. That is to say, if business activity went down, the yield from taxes would drop, without any change in the tax rates. At the same time, Federal unemployment payments would rise, again

without any change in the rates, merely because more persons were unemployed. To this extent the operation of the Full Employment Standard would be automatic, within the limits of existing legislation.

It probably would turn out to be desirable to supplement these "automatic" fluctuations in the net budget position with certain outlays which would be varied to suit the situation. These outlays might be in two principal directions: (1) public works; and (2) retirement of the war debt. The way in which these fiscal operations would work out may be illustrated by considering what the budget position would be in a good postwar year, and in a poor postwar year. The tax estimates assume a corporation income tax rate of 40 per cent, and individual income tax rates and other taxes about equal to the 1940 levels.

The budget figures below suggest that in a good year some 2 billion dollars would be subtracted from the country's money; and in a poor year 8.6 billions would be added to it. These increments and decrements would be produced by the fiscal-monetary system; but it would not be the only agency affecting the quantity of money. The banking system would also be creating new money, and, probably, occasionally contracting the supply. In a good year, for example, the banking system might create 3 billion dollars of new money. This figure, minus the 2 billions retired through the budgetary surplus, would leave a net increment of 1 billion. Conversely, in a poor year, the banking system might contract by 1 billion, which, subtracted from the 8.6 billions supplied through the Treasury, would produce a net increment of 7.6 billions.

TABLE 16

THE POSTWAR FEDERAL BUDGET IN A GOOD YEAR  
(Exclusive of Social Security Taxes and Payments)  
*Circa 1950*

National Income equal to \$144,000,000,000	
Receipts	(In billions)
Individual income taxes .....	\$ 6.0
Corporation income taxes .....	7.0
Excise taxes .....	4.0
Customs duties, estate and gift taxes, and miscellaneous	2.0
Total receipts .....	\$19.0
Expenditures	
Interest on the public debt .....	\$ 6.0
Military establishment .....	6.0
Provisions for veterans .....	2.0
Farm benefits .....	.5
Unemployment benefit payments .....	1.0
Regular governmental expenditures .....	2.0
Total expenditures .....	\$17.5
Surplus:	2.0 billions
Reduction in the amount of money:	2.0 billions

In this way, in good years, when people and corporations were spending their money freely, and investing at a high rate, the increments to the money supply would be small, or might even become negative.

Conversely, in poor years, when private investment and capital outlays were slowed down, the increments to the country's money supply would rise to substantial figures.

#### THE FUNCTION OF FEDERAL TAXES

The function of Federal taxes is preventing inflation. The Federal government literally does not have to col-

TABLE 17  
THE POSTWAR FEDERAL BUDGET IN A POOR YEAR  
(Exclusive of Social Security Taxes and Payments)  
Circa 1950

National Income equal to \$130,000,000,000	
Receipts	(In billions)
Individual income taxes .....	\$ 5.0
Corporation income taxes .....	5.0
Excise taxes .....	3.5
Customs duties, estate and gift taxes, and miscellaneous	1.5
Total receipts .....	\$15.0
Expenditures	
Interest on the public debt .....	\$ 6.0
Military establishment .....	6.0
Provisions for veterans .....	2.0
Farm benefits .....	.6
Unemployment benefit payments .....	3.0
Public works .....	2.0
Regular governmental expenditures .....	2.0
Total expenditures .....	\$21.6
Deficit:	6.6 billions
Plus: Retirement of debt:	2.0 billions
Increase in the amount of money:	8.6 billions

lect taxes in order to get the money for its expenditures. Like any other sovereign government, our Federal government has the power of creating money. If the Federal government wished to do so, it could collect no taxes at all, and create each year the entire amount of money needed to cover the government's expenditures and debt-retirement outlays.

Creating enough money to finance the entire budget of expenditures without any taxes at all would, however, be inflationary. Hence it is necessary to levy taxes. The col-

lection of taxes is deflationary. Collecting taxes takes money away from the public, and reduces the amount of money that the government needs to create. The amount of taxes that should be collected depends, therefore, on whether the country needs deflation, or some monetary stimulus.

#### FEDERAL EXPENDITURES

Federal contributions to unemployment benefit payments represent a simple, flexible method of introducing a compensatory element into the income stream and the money supply. The hypothetical postwar budgets, therefore, include fairly large amounts of money for this purpose. Presumably these amounts would be used to match state contributions on a dollar-for-dollar basis.

The use of expenditure on public works has a drawback which the "automatic" change in receipts and expenditures do not have. If business activity drops, the decline in tax revenues and the increase in unemployment benefit payments start soon; and if business improves their opposites start at once. Public works can be started fairly promptly if they have been planned in advance. Once started, however, certain types of public works (e.g., a new library building) cannot be suspended without risking the loss of what has previously gone into them. Even such works may, however, be deemed to offer some brick and mortar return in exchange for the public funds as against none whatsoever in the payment of unemployment benefits.

The objects of Federal expenditure on public works would have to be chosen with care. They should be as nearly noncompetitive with private industry as possible,

in order not to discourage private enterprise and private investment. They probably cannot quite equal the Gold Standard in this respect since it is, of course, the Supreme Boondoggle—first the ore is dug out of the ground, then it is refined, then it is transported to Fort Knox, and put back into the ground. There are, however, many other items which are admittedly appropriate objects of public expenditure, such as highways, schoolhouses, libraries, and flood control projects. These and other projects do not need to be constructed regularly every year. If the entire operation were planned with care, construction at intervals would be an entirely satisfactory arrangement.

#### PAYING OFF THE FEDERAL DEBT

The end of the war leaves the country saddled with a Federal debt of some 300 billions. The interest on the debt will require annually some 6 billions. Reducing the debt by orthodox means would require additional taxation. As has already been noted, the key difference between the Full Employment Standard and the many similar plans for compensatory governmental spending is that some at least of these plans imply a continuous and indefinite increase in the public debt, where as the Full Employment Standard proposes to finance the Federal expenditures by creating new money. Moreover, it is proposed that as part of the compensatory spending mechanism some of the newly created money be used to pay off the public debt, with a view to ultimately extinguishing it completely, without taxation, in this painless and stimulating fashion. The following figures suggest that the debt could be paid off soon after the end of the twentieth century.

Of the 300 billion-dollar debt, about 100 billion will be held by banks, the other 200 billion by business corporations, insurance companies, individuals, and other non-banking entities. The retirement of the 100 billion that will be held by the banks presents an exceptionally simple problem. The Board could create funds and pay off these holdings virtually at will, without creating inflationary pressure, since the redemption of such bank-held Federal obligations with created money would merely enlarge the banks' cash reserves. The process would not increase the nation's money supply a nickel, since bank reserves are not cash in the hands of the money-spending public and corporations. Bank reserves are available for lending, and do not create new money until the loans are made.

But would the increased reserves lead the banks to increase their loans and thus increase the quantity of money? Not necessarily; the banks have to find borrowers first. But, if they did, and their success seemed to be leading to an undesirable credit expansion, the Board could always control it by raising the legal minimum reserve ratios. That is, at the same time that the banks were given more cash, they could be required to hold more cash. Thus there would be no monetary effects flowing from that debt repayment. The payments to the banks would be neutralized by the increased reserve requirements.

Repayment of the 200 billions that will be held by individuals and corporations is, however, another matter. There is no simple way of neutralizing their new cash; so it would have to be paid to them judiciously.

How rapidly could this part of the debt be repaid? The



answer to this question may be approximated by some simple calculations, based on the expectation that, in the future, the expansion of bank credit would supply about one-third of the needed money increments, and the Full Employment Standard the other two-thirds; of these two-thirds, half would go to paying off the debt, the other half to financing budgetary deficits. Then, with the country having 135 billion dollars at the end of the war, an approximate schedule would look as shown in Table 18.

TABLE 18  
SOURCES AND USES OF MONEY INCREMENTS, 1950-1980  
(*In billions of dollars*)

	Amount Needed	Amount Needed in Decade	Increment Supplied by Bank Credit	Increment Used to Pay Off Debt	Increment Used to Finance Budget Deficits
1960 ....	\$173	\$ 38 (to \$135)	\$12	\$13	\$13
1970 ....	255	82	27	28	27
1980 ....	363	108	36	36	36

By the year 1980 some 77 billion dollars of the debt would be paid off. If the needed expansion of the country's money supply were to continue at about the same rates in the decades following 1980, the rest of the debt could be retired not long after the turn of the century.

#### THE EFFECT ON BANKS AND BANK RESERVES

As the government paid out these funds from its Federal Reserve accounts, most of the money would be deposited in banks (all of it except the increase in hand-to-hand circulation), and would become bank reserves,

constituting, as the law now stands, a basis for a possible expansion of bank credit. Whether one believes that this should be permitted to occur depends on one's views on the 100 per cent bank reserve plan.

Evaluation of the 100 per cent bank reserve plan would be somewhat too involved for brief discussion here. Furthermore, the question lies somewhat off the path of this discussion, in the sense that the Full Employment Standard is necessary and can operate no matter which banking system prevails. If the banks are allowed no independent creation of money (the 100 per cent reserve plan) the amount that the State must create is thereby increased. If the banks are allowed to create additional money, they probably will not create enough and are likely to contract the quantity at the wrong times.

The Full Employment Standard, furthermore, is not incompatible with either of these systems. It is no more so than is the gold standard. If the banks are allowed to continue their money-creating and money-destroying activities, the operation of the Full Employment Standard would be complicated somewhat, but only slightly.

Only slightly, because the fluctuations in bank credit are not only a *cause* of cyclical fluctuations; they are also a *result*—expansion begets more expansion; contraction begets more contraction. The stability induced by the operation of the Full Employment Standard would reduce the tendency of bank credit to gyrate as much as it has in the past.

I conclude that for the present, at least, it would be unwise to adopt the 100 per cent bank reserve plan. Let the banks continue to operate just as they have in the past.

The Full Employment Standard would not affect them, except by continually increasing their reserves.

#### REPRESSIVE ACTION

So far, nothing had been said about the possibility of operating the Full Employment Standard so as to *reduce* the quantity of money. Is the Standard a one-way machine only—good only to stimulate business by ever increasing the quantity of money? No, the Standard's logic includes decreasing as well as increasing the quantity of money. Why, then, does the discussion run so extensively in terms of *increases*, of stimulus to spending? There are four reasons:

(1) The nation's capacity to produce is huge and is continually increasing. Hence, the amount of spending on capital goods and consumers goods that is necessary to produce full employment is enormous and keeps growing. Therefore, the problem of *stimulating* monetary demand adequately will be almost continuous. The necessity of damping down monetary demand because spending is running away, on the other hand, is likely to occur very rarely, if indeed ever.

(2) Since the nation's secular need for money is so sharply upward, a reduction in the rate of increase (perhaps to zero) would very quickly have an adverse effect on prosperity without going to the more drastic step of actually reducing the total amount of money.

(3) Checking an excessive expansion of spending is a relatively easy trick. Excessive spending can occur only as a result of general and widespread enthusiasm about the business outlook. It requires a state of optimistic overconfidence in the outlook for profits and investments.

This happy frame of mind could be chilled easily by determined official action. A mere warning by the Stabilization Board would probably be all that would be necessary to stop the enthusiasm, since all responsible persons would know perfectly well that the Board had entirely adequate power to diminish monetary activity.

(4) Credit control is a very effective device for *contracting* the volume of money. In other words, the Board need not rely on budgetary action alone to reduce the quantity of money in order to check a tendency toward excessive spending. It has two other effective repression instruments: official warnings and credit control.

#### ADMINISTRATION

As the analysis in this chapter indicates, the operation of the Full Employment Standard would, in part, be "automatic." Budget surpluses in good years would reduce the amount of money. In poor years budget deficits would increase the quantity of money. Certain outlays, however, e.g., on public works and debt retirement, would not be automatic, but would have to be determined in respect both to magnitude and timing. Furthermore, the determination of the level of tax rates and of regular expenditures is not a simple matter. These problems not only are difficult and complicated, but they involve actions by both the executive and the legislative branches of the government.

For these reasons, it is suggested that the operation of the Full Employment Standard be vested in a Federal Stabilization Board, assisted by a Federal Stabilization Advisory Committee. The other factors in the prosperity program would also be under the jurisdiction of the same

agencies. In them would be centralized the direction and coordination of the entire stabilization plan.

Now obviously the success both of the Full Employment Standard and of the other parts of the program would depend on the competence with which they were administered. This in turn depends on the quality of the personnel on the Board and the Advisory Committee and their ability to operate free from political considerations.

There must be a wide range of opinion with respect to the likelihood of securing the desired competent personnel and nonpolitical administration. The very importance to the nation of the work of the Board and the Advisory Committee should facilitate getting high-grade personnel and should guard against their being guided and motivated by any consideration other than the public good. My own expectation in this regard is optimistic. I believe that, assisted by an expert staff, the two bodies could be expected to do a good job. Furthermore, it is something that must be tried; the chance must be risked, since a do-nothing policy would present even greater dangers. On the one hand, we have the danger of mismanagement of a stabilization program; on the other hand, we have the danger of mass unemployment and social upheaval. Of the two, the latter is both a greater danger and more likely to occur. Therefore, the less risky course is to establish a stabilization program, and to make every effort to see that it is skillfully administered. Distrust of the none-too-perfect machinery of Democracy in this matter would be likely to result in some form of collective, perhaps tyrannical, management of society in the end.

## CRITICISMS OF THE FULL EMPLOYMENT STANDARD

It probably would not be possible to anticipate all of the criticisms and objections that might be directed at this fiscal-monetary mechanism. Certain ones, however, are inevitable, and therefore merit comment.

1. Criticism: "The Full Employment Standard is just a crack-pot paper money scheme." A scheme it is, even a money scheme. It may perhaps be described as a paper money scheme. The money created is not really paper; it is a deposit balance in the Federal Reserve. But the money is not "backed by" or "based on" any metallic substance; and this is what some persons mean by the term "paper money."

But does money need to be based on or backed by some metallic substance? Certainly not in any genuinely functional sense. Paper money would be functionally quite satisfactory if the legend on the face were merely these words: "United States of America—One Dollar." The fact that paper money has a metallic base originated in the evolutionary process which brought mankind this useful tool. Stamped pieces of metal yielded to pieces of paper which were either warehouse receipts for pieces of metal or promises to pay pieces of metal. The pieces of paper would be just as useful, however, if they were unrelated to pieces of metal, unless public psychology would not accept them.

The basic comment on this criticism is that the new Standard represents a money-creating mechanism which is based on the functional role of money in an expanding economy, if that economy is to enjoy prosperity.

2. Criticism: "The entire plan is unsound because it

is merely a scheme for us to lift ourselves by our own bootstraps." Curiously enough, it *is* a scheme for us to lift ourselves by our own bootstraps. *Because this is the only way that we can get ourselves up to full employment.* Who do the critics believe will lift us—the distant Martians? Our late foes, the Germans? Our friends, the Chinese? No, we and we alone can lift the American people to full employment, by buying the output of American workers. We pull ourselves down into depression by our own hat brims, and the only way we ever get out is by lifting ourselves by our own bootstraps.

3. Objection: "The Full Employment Standard is a departure from sound money." It is a little hard to say what the term "sound money" really means, since it often stands for an emotional attitude rather than a definite or positive thing. If sound money be taken to mean a currency convertible into gold at fixed rates, the Full Employment Standard is definitely not such. The new standard represents a giving up of the metallic standard in favor of a system that will contribute to prosperity and full employment. In this view, the gold standard is an anachronism and a handicap, which economic progress will discard.

The affection for "sound money" in the minds of more sophisticated critics probably indicates not a mere desire for metal-backed money as such, but rather a distrust of political control of the quantity of money. This criticism involves the matter of the quality of the administration of a "managed" monetary standard, which was discussed earlier in this chapter. It seems to me that the balance of risks favors trying to operate our monetary system on the new basis, rather than the old. A friend, discussing

monetary matters, observed to me in 1933, "Don't forget; we have paid a thumping good price for sound money." He was right, but not in the sense that he meant it; and we paid even more in the rest of that Dismal Decade. The price of "sound money" in the future would most likely be even higher.

That money is soundest which contributes most to the economic well-being of a country. Judged by this criterion, is not the Full Employment Standard the sound one, and the Gold-and-Bank-Credit standard the unsound one?

4. Criticism: "The Full Employment Standard would be inflationary." It is true that the Standard *could* be inflationary; and it *would* be if the quantity of money were increased too rapidly. If, however, as the analysis of Chapter 3 shows, the amount of money were increased at a proper rate, the effect would not be inflationary. The basic point is that in an expanding economy a considerable increase in the quantity of money can occur without causing a price rise. In an expanding economy, a stationary quantity of money will precipitate a decline of prices. *Some* increase in the amount of money is required in order to keep the price level unchanged.



## Complementary Plans and Policies

EFFECTIVE though the Full Employment Standard would be in contributing to stabilized prosperity, it would not need to stand alone. There are other plans and policies which are important, and which are complementary both to one another and to the Standard. Together, these weapons would constitute an armory of defense against depression and unemployment.

No attempt will be made to discuss in this chapter all of such worth-while plans and policies. Doing so would require a lengthy presentation, and would, moreover, be unnecessary, since the purpose of the present chapter is not to present a complete and detailed program. The purpose, rather, is to show how the Full Employment Standard would fit in with other representative, important factors in such a program. Since the factors that will be taken up are quite well known, their description will be brief; and the discussion will be more concerned with indicating their complementary nature.

The plans and policies that will be discussed are these:

1. Business contributions to stability.
2. Governmental policies to encourage enterprise and investment.
3. Sensible price policies by business.
4. Sensible wage policies by unions.
5. Control of bank credit.
6. Official pronouncements by the Federal Stabilization Board.

### BUSINESS CONTRIBUTIONS TO STABILITY

The principal responsibility for achieving and maintaining prosperity and full employment belongs to the

Federal government, because the ultimate power of monetary control is lodged there. This does not mean, however, that private business has neither responsibility for or power to affect the volume of employment. In the main, the amount of employment which private business can provide depends on the amount of goods and services that private business can sell at a profit. The chronic tendency toward an inadequate market that would exist if the country's money supply were too small would be something that private business could do nothing about. The tendency of a business slump to become cumulatively worse is something that private business can hardly be expected to attempt to arrest, since the path of wise individual action at such times is to contract one's commitments. It is a perfect case of individual wisdom meaning collective folly; yet it would hardly be reasonable to expect that individuals should behave otherwise. It is not for any one of them to bell the cat; that job must be undertaken by someone big enough to cope with the creature. That "someone" in this case is the Federal government.

What, then, can private business do? Two general areas of thinking and acting, as I see it, are indicated. The first consists of a serious effort by private business to understand fiscal and monetary matters at the "high policy" level, and the part that governmental operations in these areas could play in stabilizing markets and business. Up to the present, with the exceptions of the Committee for Economic Development and certain others, the business community seems to have made very little effort to understand modern thinking about such topics as gold, money, spending, saving, investing, employment, and

prosperity. As a consequence the thinking of many businessmen on these vital matters is rather primitive.

Business and banking circles in England seem to be much in advance of ours in this regard. It is not possible to say with certainty why this disparity came to exist. Perhaps relatively more British economists respected by the businessmen have expressed progressive views. Perhaps it is because the English have been spared the misfortune of having these matters become the objects of violent controversy in a prejudice-ridden fight between the business groups and the country's political administration. Whatever the causes, the condition is clear. The existence of the condition was made indisputable when a Conservative-dominated British Government issued the white paper on Employment Policy. In its calm, lucid English way the white paper enunciated doctrines which would, in the United States, be regarded as definitely unsound, nay, even New Dealish. It is highly important that American businessmen examine these matters and correlative proposals on their merits and without the handicaps of economic superstition and political prejudice. Then they would be prepared to accept, to assist, and to have confidence in any basically sound, albeit novel, programs, to their own gain and the gain of the nation.

The second broad area of thinking and action in which the business community could make a contribution is the encouragement of enterprise and stability in capital outlays. These would be large and difficult aims; but their implementation would be most helpful.

GOVERNMENTAL POLICIES TO ENCOURAGE ENTER-  
PRISE AND INVESTMENT

Governmental policies to encourage enterprise and to stabilize investment are an important part of a full employment program. The need for changes in today's policies, however, is easily exaggerated.

Under an individualistic economic system the establishment of law and order marks the beginning of economic progress; then men, freed of the fear, nay, the expectation of being despoiled of their goods by marauders, are willing to work and to accumulate goods. From that point on, many factors combine to determine a nation's prosperity. Among them, governmental policies with respect to matters economic hold an important place. Tariffs, taxes, subsidies, protection of property, regulation of competition and competitive practices, control of investment processes, laws relating to corporations, labor legislation, consumer protection, and the rest of the entire congeries of laws, actions, and activities that affect business constitute a vital part of the milieu in which people carry on economic activity and condition to a substantial extent the nature and volume of that activity.

Each of the topics listed in the preceding paragraph is a fit subject for extended discussion, which cannot be undertaken in this little volume. Fortunately for the adequacy of the prosperity program, the situation with respect to governmental economic policies, though not ideal, is far from being so bad as the unfriendly critics would have us believe. Putting the matter positively, the present status of governmental policies is much less of a hindrance to prosperity than many critics assert it to be.

Unfortunately, this subject is a battle ground for political enthusiasts. The firing from both sides is so sharp that the middle-of-the-roader who is trying to follow the thread of truth is in grave danger of being the target of both parties. Calm analysis indicates that the claims of the opposing schools of political thought with respect to the "soundness" of either group's policies are exaggerated. The truth is that both Old Deal and New Deal witnessed a great deal of unemployment. Governmental policies in 1929, 1930, 1931, and 1932 were probably what most men would describe as conservative, and, in a conservative way, encouraging to business enterprise. Nevertheless, to the bewilderment of the captains and the kings, as well as the common man, the great toboggan slide began under these conservative auspices and plunged the nation into the greatest depression in its history.

In 1933 came new faces, new activities, new programs; came also business improvement (which might have come anyway—the world upturn began in the summer of 1932). Nevertheless, some unemployment persisted; in March 1933, when the new group took over, there were 14 million unemployed. Five years later, although the number was lower, there were still more than 11 million without work.

Under one set of policies the depression began; under another it lingered. The trouble was something other than governmental policies.

Sound governmental policies are a *necessary* condition for full employment, but they are not a *sufficient* condition. This proposition can perhaps be illustrated by analogy. If one wishes to keep the interior of a building

at an even temperature by means of heating and air-conditioning devices, it is essential that the building itself be a well-constructed, well-insulated edifice. Keeping the temperature in a bamboo house steady, even with heating and air-conditioning devices, would be very difficult, perhaps impossible. But that the edifice be well built is not enough. A well-built house without any heating or cooling apparatus would be very cold in the winter and very hot in the summer. That the house be well built is a necessary condition to maintaining an equable temperature, but it is not a sufficient condition; in addition, there must be devices for offsetting the tendency of the interior temperature to fall in the winter and to rise in the summer. These devices are the simple ones that warm the interior air or cool it.

Similarly, with the economic system, sound governmental policies are essential; but they are not sufficient. In addition, some mechanisms must be employed to prevent the inherent instability of the capitalistic system from manifesting itself in general fluctuations of business activity and employment. The variable parts of the program are such mechanisms.

In the postwar period the key to prosperity will not be changes in governmental policies. In my judgment useful changes in governmental policies would be rather few. The following would seem to be helpful.

1. Tax reform. A general lowering of the high war time tax rates will be in order as soon as the possible inflationary threat is over. Both individuals and corporations should be allowed to average their incomes over a period of years—say, five years. The tax exemption privilege of government bonds should be eliminated, thus re

ducing the attractiveness of this non-venturesome type of investment.

2. A sensible anti-monopoly program. Not as a witch-hunting activity, but as a search for harmful monopolies, there should be a calm campaign of enforcement of the anti-trust laws. The Federal Trade Commission must continue its campaign against restraint of trade and unfair competition.

3. Assistance to small business. It is of the utmost importance to an enterprise program (as well as to our democratic way of life) that a man should be able to go into business for himself, and, if he is industrious and competent, be able to make a success of it, and not be foredoomed to failure merely because he starts on a small scale. Today, in many lines, the large corporation has a big advantage over the little fellow. A certain amount of this advantage ought to be taken away. I say "a certain amount" because there is no intent to penalize large business to the point where (say) no railroad could afford to own or operate more than ten miles of track. Bigness is enough of a technological advantage in some cases to justify its existence.

These are some of the things that should be done to assist small business.

(1) Lower corporation income tax rates, especially at the start of a new business.

(2) Federal subsidies for industrial research, either in Federal agencies or in university or other similar organizations. The results of these researches would be available to large businesses as well as small ones; but the latter, being less able to afford research facilities of their own, would be more likely to gain from these facilities.

(3) The prevention of unfair competition by the Federal Trade Commission would be an important gain for small businesses in many cases.

#### SENSIBLE PRICE POLICIES BY BUSINESS

Business managers would help the nation's economy by reducing the prices of goods whenever technological changes or other production improvements reduce the unit cost of the goods. In many cases, failure to reduce such prices may be depriving the company itself of the gains that would flow from capitalizing on an elastic demand.

The price-reducing policy may be classified as helpful. Its opposite, a price-raising policy, might be fatal to the prosperity program. If the quantity of money were increased, in order to induce people to spend more freely and thus to provide a market for more goods, the desired effect could be nullified if the sellers of the goods were to increase their prices in the same proportion. In that case the monetary stimulus would not provide more jobs; but would spend itself in price inflation.

This undesirable policy is, I think, unlikely to be followed very widely by businessmen. They may be slow to reduce prices; but they are also hesitant to raise them. Nevertheless, the danger is worth noting. A sensible price policy represents another way in which the business community could contribute to stability.

#### SENSIBLE WAGE POLICIES BY UNIONS

The necessity for sensible wage policies is the same as the necessity for sensible price policies. There is this difference. Because of increasing per capita production,



real wages will rise gradually. Therefore, unless the cost of living were to decline steadily and fairly rapidly, the normal trend of money wages must be upward. Money wages, in other words, should rise, relative to the cost of living.

Even though wage rates may be expected to increase, they could be pushed up too rapidly, thereby choking off the attainment of full employment. Such an overly rapid advance of wage rates would either impinge improperly on profit margins, or would lead to the type of undesirable price increases described in the preceding section. In the one way, employment is discouraged because employers are not making sufficient profits. In the other way, employment is choked off by the high prices of goods.

#### THE ROLE OF THE FEDERAL STABILIZATION BOARD

The role of the Federal Stabilization Board with respect to the four types of policies discussed above would be that of making studies, of offering suggestions, of disseminating information, of coordinating plans and policies, and of making recommendations to governmental bodies, to business, and to labor unions.

In addition to these types of useful activity the Board would also have the principal directive responsibility for the fiscal-monetary operations, and would inherit the Federal Reserve Board's authority over our central banking system, with its powers of control over bank credit.

#### CREDIT CONTROL

Credit control is not a new or unorthodox device. The procedures described below are already in operation.

There is, therefore, virtually nothing new about this piece of control machinery. The only new aspect is the minor one that the Federal Stabilization Board, taking over this function, should be authorized to make larger variations in the legal minimum reserve ratios of the member banks than the Federal Reserve Board is now authorized to make.

In addition, there is a difference in emphasis. In most discussions of credit control, it is described as being a two-way instrument—capable of either restricting bank credit or of expanding it. In the present program, however, credit control is visualized as being primarily a restrictive device; not as a significant stimulative force. In this view, the familiar simile is expressive: Credit control is like a rope; you can *pull* with it, but you can't *push* with it. Weak though credit control is as a stimulative device, however, it is not in any sense weak as a restrictive mechanism. It is potentially so powerful on the restrictive side that, if it were used full force, even the most vigorous spending boom would be brought to a standstill.

Control of bank credit is a powerful device because, by the use of appropriate methods, the banks can be influenced to reduce their loans and investments, thereby reducing both the total amount of money and the total volume of spending. This process is the opposite of the familiar expansionist one by which the banks increase the quantity of money by increasing their assets. Obviously, such a controlled reduction of the amount of money would be, in an expanding economy, a potent restrictive operation. It would speedily end an over-spending boom. Indeed, the mere announcement that such action was to be taken might end the boom then and there.

Since credit control is such an important device, let us take a look at its method of operation. Basically, the secret of credit control is control over the volume of the excess reserves of the banks. What are excess reserves? Excess reserves are that part of its reserve cash that a bank has in excess of the amount that it is required by law to hold. An imaginary example will make this clear. Let us suppose that the First National Bank has \$100,000,000 of deposits—that is, that its balance sheet shows that individuals, corporations, and others have that amount deposited in this bank. Let us also suppose that the First National is required to have cash reserves at least as large as 10 per cent of its deposits. In this case, then, the legal minimum reserve would be 10 per cent of \$100,000,000; or \$10,000,000. Further, suppose that the bank has total cash reserves of \$15,000,000. It then has \$5,000,000 of *excess* reserves. The magnitude of a bank's excess reserves is a restrictive factor in its lending and investing operations. Since the First National has substantial excess reserves, it can, if it wishes, increase its loans and investments. If the banks of the entire country generally are in this position, the reserve situation is "easy," and bank credit may expand.

This reasoning puts us on the track of the method used by the Federal Reserve to influence the banks to contract their credit. It does so by reducing the banks' excess reserves, thus squeezing the banks into credit contraction.

The Federal Reserve has two methods of reducing the banks' excess reserves. The first is by engaging in what are called Open Market operations—which means selling some of the government bonds which the Federal Re-

serve owns. In our imaginary example of the First National Bank, suppose that the Federal Reserve sells \$6,000,000 worth of government bonds to people who were depositors in that bank. As the buyers pay for the bonds, the bank will lose \$6,000,000 of its cash reserves. Its reserves will drop from \$15,000,000 to \$9,000,000. Since its deposits have also dropped \$6,000,000—from \$100,000,000 to \$94,000,000—its legally required minimum reserves now equal \$9,400,000. Therefore the First National no longer has any excess reserves; indeed, its reserves are deficient by \$400,000. Both the law and the custom of having at all times at least a modest amount of excess reserves now prompt the bank to build up its reserve position. The bank does this by reducing its loans and sellings its investments. If the banks generally are doing these things, the end result will be a contraction of the nation's money supply.

The second way in which the Federal Reserve can reduce or extinguish the excess reserves is less subtle and more direct. It is the exceedingly simple process of raising the legal minimum reserve ratio. Reverting to our imaginary example, we started out with the First National Bank having \$100,000,000 of deposits, \$15,000,000 of reserve cash, a legal minimum reserve ratio of 10 per cent, and excess reserves, therefore, of \$5,000,000. A simple and direct way for the Federal Reserve to eliminate the \$5,000,000 of excess reserves is to raise the legal minimum reserve ratio from 10 per cent to 15 per cent. The First National would then need \$15,000,000 as legal reserve, which is exactly what the bank has as cash reserve; and it then would have no excess reserves at all. The excess reserves would have disappeared. A further increase in the legal minimum reserve ratio to (say) 20 per cent

would actually make the First National deficient in reserves, and would put strong pressure on the bank to contract credit.

In simple terms, then, this is what the Federal Reserve can do to the banks: The Federal Reserve can take away the banks' free cash, and, in effect, require the banks to contract their credit. As the banks reduce their credit, they cut down, *pari passu*, the amount of money in the country.

At the present time, the Federal Reserve Board possesses the legal authority to raise the member banks' legal minimum reserve ratios by modest amounts. As a part of an adequate control system, the postwar Federal Stabilization Board should be authorized to raise these ratios to whatever level is deemed necessary. In other words, the present rather modest weapon against credit overexpansion and inflationary spending should be made stronger.

These restrictive credit controls, thus strengthened, would be powerful and absolute. They would be so potent, indeed, that they would have to be used rather gently, since their use on a large scale would have a sledge-hammer effect on the nation's monetary activity.

Actually, to repeat a thought expressed more than once in these pages, there appears to be but little likelihood of the American economic engine's being overspeeded by a too large volume of spending. Should this happen, however, the Stabilization Board would have, in credit control, a weapon powerful enough to stop any possible spending boom.

#### OFFICIAL PRONOUNCEMENTS

A control device which the Board would find useful for restraining overenthusiasm and checking excessive

spending (should the conditions ever occur) is an official pronouncement. A declaration could take the form of a simple statement that the machine was going a little too fast, and the Board would, if necessary, utilize its financial instruments to slow it down. Since the financial instruments would be powerful and all sophisticated persons would understand their power, a word to the wise would be sufficient to cool the overconfidence.

It may be objected that official pronouncements were used freely after October 1929, without any effect. Men of standing, from the President down, reassured the American people that business was fundamentally sound, and that the business recession would be mild and short-lived. Nevertheless, it kept getting worse, and eventually, despite a long-continued barrage of pronouncements, became the Great Depression. Whence then, it may be asked, this new confidence in official pronouncements as a regulator of business activity? The answer to this most reasonable question is twofold.

1. Pronouncements are more effective as a restraining device than as a stimulator.

2. The effectiveness of pronouncements depends on who makes them and what they say. There is a great deal of difference between a "big man's" assurance that "Business will soon start to improve" and the statement by a Stabilization Board, armed with powerful control devices, that if a given trend continues they are going to use their potent mechanisms to reverse it. Official pronouncements would constitute a psychological tool which would be especially useful to the Board in restraining an excessive business expansion.

## AN INTEGRATED PROGRAM

The foregoing plans and policies together comprise an integrated prosperity program. The first two listed in this chapter—business contributions to stability, and governmental policies to encourage enterprise and investment—would be expected to provide a steady and continuous stimulus to business activity. They are not variable in their effect; but exert an upward influence.

The next two factors—sensible price policies and sensible wage policies—are important for the sake of preventing a stimulated demand for goods from being dissipated in a price-and-wage inflation instead of resulting in the sale of more goods and the employment of more workers to make the more goods.

The last three factors—credit control, official pronouncements, and the Full Employment Standard—would be administered by the Federal Stabilization Board. All three are variable instruments; they may be turned on or off. Furthermore, all three may be utilized either to stimulate or to repress the volume of spending. To be sure, credit control and official pronouncements would be much more effective in restraining overexpansion than in stimulating a dull situation. If the Board had at its command only these two tools, it would not be adequately armed with stimulative powers. The peculiar merit of the Full Employment Standard is that it can be used to give either a negative or a positive stimulus to business; and that the positive stimulus of increased net income-generating Federal expenditures and other outlays, and the correlative increase in the quantity of money would be a potent mechanism for supporting the streams of income and expenditure.

## International Aspects of the Prosperity Problem

CONSPICUOUS by its absence from the foregoing program for postwar prosperity is a plank dealing with international trade and financial relations. Some persons would regard this as a serious omission, and would contend that a prosperity program is seriously incomplete that does not include plans for encouraging and developing international trade and finance.

The basic thinking underlying this international view is really a philosophy rather than a solution, but it touches on a matter which is so fundamental as to call for careful consideration. It may, I think, be expressed in the following compound proposition:

1. The United States is, whether we like it or not, one of the family of nations.
2. Our prosperity is intertwined with that of the other countries, so that we cannot be prosperous unless the other nations are prosperous also; in other words, we cannot be prosperous all by ourselves.
3. Therefore the conclusion is that the only type of program that could bring prosperity to our country would have to be one that would make the other countries prosperous also.

Before getting on with a discussion and appraisal of this proposition, a significant observation is in order. It is this: This book, and the entire analysis that it contains, and the proposals made, apply to the United States of America. Offhand, this statement may sound selfish,



or even, to use a word hurled by some as the ultimate in illiberal epithets, "isolationist." In fact, however, it is neither.

The observation is not selfish; it merely delimits the field of diagnosis and prognosis. Surely a man cannot be

TABLE 19

## PRE-WAR AVERAGE PER CAPITA INCOME IN FOREIGN COUNTRIES

United Kingdom .....	\$454	U.S.S.R. ....	\$136
Germany .....	452	Finland .....	125
Australia .....	416	Japan .....	87
New Zealand .....	408	Bulgaria .....	77
Canada .....	373	Chile .....	77
Sweden .....	351	Estonia .....	76
Belgium .....	264	Greece .....	75
Denmark .....	249	Poland .....	68
France .....	234	Yugoslavia .....	68
Norway .....	200	Rumania .....	48
Austria .....	157	India .....	32
Hungary .....	138		

fairly accused of being selfish if he announces that he is working on his own country's chief economic problem, and is leaving to others the job of working on other countries' problems.

Moreover, and this is of economic rather than moral significance, the nature of the economic problem is basically different in different countries; confusion of thought would result from not recognizing this fact, and unfortunate results would follow from giving all the patients the same treatment. Some nations are basically richer than others. As Table 19 of pre-war incomes of

foreign countries shows, the per capita income of people differs tremendously in different countries. At the top were the United Kingdom, Germany, and Australia. In these countries, the normal average income was more than \$400 per person. At the bottom were India, Rumania, Yugoslavia, and Poland. In these poor countries the average per capita income was less than \$70 per year.

In the poor countries the economic problem is not that of maintaining full employment; there never is much unemployment in such predominantly agricultural countries. The real economic problem in these countries is that of how to increase production, how to raise per capita output. These peoples are wretched because each man produces so little. The solution to this problem lies along lines of improving technological processes, of securing mechanical equipment, of educating the people, of securing efficient industrial management, and of using effective production methods. These are the ways in which the poor countries' peoples could advance to a higher standard of living, an end which all humanitarian people must enthusiastically approve and be willing to assist.

The statement of their problem and the nature of its solution, however, should make it immediately clear that the economic problem in the high-standard countries is substantially different. In the United States, the per capita output is not low. In fact, per capita production is so extraordinarily high that the real problem is how to provide enough monetary demand to buy all the goods that all the workers can produce, and thus keep them all employed.

This point may be seen most clearly by looking at the

figures for average per capita incomes in the United States in good years and bad years.

U. S. AVERAGE PER CAPITA INCOME IN PROSPERITY AND DEPRESSION

1929, \$685    1932, \$321    1942, \$903

These figures indicate two things. First, that the United States is a rich country. Even in a bad year, the average American is better off than most people of the world. In other words, the basic problem of economic productivity is pretty well solved in this country. In the United States the economic problem is how to keep all these immensely productive workers fully employed.

The foregoing discussion has laid the groundwork for the appraisal of the international proposition with which we started, which was that the United States cannot be prosperous by itself, and, therefore, a successful program would have to be one that would make the other countries prosperous also. Appraisal of this proposal is not overly difficult, but a statement of the appraisal is not easy, because the proposal is partly true and partly untrue.

By way of anticipating the analysis, let a brief, double-barreled appraisal be registered: (1) In the largest and most significant sense, the proposition is not true; (2) In a very special sense, there is a limited amount of truth, but not enough to justify the conclusion.

The discussion in the earlier paragraphs has already foreshadowed the present comment. The people of the United States are, and for many decades have been, more prosperous than the people of most other countries. Their prosperity rests basically on their high per capita production, which is something that poor India and poor Greece

cannot take away from them, or even threaten. The average American farmer and industrial worker, with the aid of modern equipment, good organization, education, and effective methods, produces a large amount of goods. Moreover, these favorable factors are continually improving. There is a marked upward trend in per capita output. The trend will continue. Our children and our children's children will enjoy a much higher standard of living than we do, *no matter what happens to the standard of living of poor Rumania, poor Yugoslavia, and poor Poland*. Note that this statement is strictly and purely *economic*; one's interest in the poor countries is a matter of friendship and humanitarian feeling for *their* peoples, not of consideration for the economic well-being of the United States.

#### INTERNATIONAL TRADE AND BUSINESS CYCLES

What, however, is the special sense in which the prosperity of the United States may be affected by the prosperity of other countries? The impact of international trade may affect us in several ways.

1. The increasing prosperity of a foreign importing country may improve the market for some specific American export, say, motorcycles.

2. The increasing prosperity of a foreign competing exporting country may be associated with a declining market for some American export, say, tennis sneakers.

Neither of these effects has a very large impact on the American economy as a whole; indeed, the net general result could not be more than a slight change one way or the other. Moreover, the only way in which we could

avoid such alterations would be to have no foreign trade at all.

3. There is yet another and somewhat different sort of way in which international trade may affect American prosperity. That is by transmitting the cyclical tendencies of the rest of the world's business to our country. If, in the rest of the world, business is getting worse, American exports will decline, and most likely, shortly thereafter, American imports will also decline, while unemployment rises. Conversely, if business is improving in the rest of the world, American exports will rise and employment will go up.

International trade, in short, is an ingenious mechanism for spreading the waves of prosperity and depression from one country to another. If there were no international trade, each country's cycle would be independent of the others. To be sure, if they are all governed by the same factor, say sunspots, they would all go up and down together, but the reason would not be the interdependence of international trade.

If, however, the countries' business cycles are not all governed by some such common factor, each would be cyclically independent. The poor countries would have little or no cyclical fluctuations. They might suffer droughts or floods, lean years or good harvests, but they would not have any noticeable true cyclical fluctuations.

Each of the relatively rich countries would have its own cycle. Each would be independent of the others. If any country were to find a satisfactory mechanism for achieving and maintaining full employment, it could operate the mechanism without reference to what was occurring in the other countries.

Do these facts, then, mean that the United States business cycle is so closely tied to the world cycle that we could not achieve high cyclical stability unless the rest of the world did also? This is a vital question, but one to which the answer, *for the United States, is clearly No.* Why? Because foreign trade is so small a part of the total American economy, and because our country's economic activity is such a large fraction of the world total. Our total exports (whose decline can hurt us) both visible and invisible do not amount to more than 8 per cent of our total gross national production. A cyclical decline of this 8 per cent may be inconvenient, but it cannot ruin us. The 92 per cent, which is what we sell to our fellow countrymen, is obviously an enormously larger controlling factor.

Specifically, the use of control mechanisms, by the United States alone, can stabilize the American economy, whether or not other countries continue to experience business cycles.

The attainment of such stability by the United States would, indeed, be a big contribution to world stability. In the past when business has slumped in the United States, Cuba has been flattened by the slump in the sugar market, Peru by the declining demand for copper, and Chile because nitrates couldn't be sold. Small though American imports of these goods are to our big economy, such goods are very important to many small countries. The American market, indeed, is so important to many countries that stabilization of the American economy would come very close to stabilizing the entire world.

Some further clarification of these matters may be provided by recognizing that the depression problem is

not basically *international*; it is basically *multi-national*. Many nations face the same problem; that is why it is multi-national. Its solution, for some of these nations (including the United States), does not depend on action by either international concert, or by other nations, but by their own domestic programs. That is why, for the United States, the problem is not an international one. Our country can deal with it successfully all by itself.

Thus we come to the conclusion that the United States can enjoy both basic prosperity and full employment whether other countries do so or not. Furthermore, we observe that our country, in doing so, could, by supplying precepts and markets, contribute to the attainment of these economic goals by the other nations of the earth.

### *The International Gold Standard*

Another international proposal is this: the world, including the United States, can achieve prosperity only by a universal return to stabilized currencies, based on gold, constituting an international gold standard.

To a certain extent the gold standard has already been discussed—with respect to its domestic and psychological aspects. This discussion need not be repeated, but the conclusion may be restated: Public affection for gold is the main argument in favor of the gold standard, and is an important factor, but it is not a permanently insurmountable barrier to monetary improvement.

The international gold standard provides a common basis of value for currencies. That is, in what are sometimes referred to as the good old days, the United States dollar was convertible into 23.22 grains of fine gold, and

the British pound into 113.001 grains; hence these two currencies were on the international gold standard, automatically and without any other mechanism. The key fact was that the ratio of the two gold contents was 113.001 to 23.22, or 4.85 to 1. These figures gave us parity of exchange, one pound equal to \$4.85. Continued redeemability and the low cost of shipping gold insured that the market price of one English pound never went above \$4.87 or below \$4.83. In other words, exporters, importers, and any other persons who had Anglo-American financial dealings could always know almost exactly the future prices of the two moneys, in relation to one another.

Between countries that are on noncommon standards, there is no metallic weight ratio that establishes a parity of exchange, and no metallic process to keep their exchange rates steady. The rates may fluctuate considerably; no one can tell in advance what the rate will be. Therefore a new element of uncertainty is introduced into international financial dealings; and exporting and importing, having an additional handicap, are discouraged somewhat. To be sure, these currencies can be bought or sold for future delivery, up to ninety days, thus eliminating uncertainty for such a period. This is an inconvenience, albeit a minor one for professional dealers. Nevertheless, neither inconvenience nor uncertainty is encouraging to international trade.

How much are international trade and domestic prosperity discouraged and decreased by these factors? No one really knows. My own estimate is very little. If international trade amounted to 10 per cent of the American national income, and if our not being on the interna-



tional gold standard reduce that figure by one-tenth, would the American standard of living go down 1 per cent? Since the valuation of commodities might change, the answer to this question is doubtful; but, before concluding that the answer is Yes, let us note that the workers who would be released from producing 10 per cent of our exports would become available to try to produce the 10 per cent of imports that would be lost. At any rate, the difference, for a country that is as largely self-contained as the United States, is very small—is, in fact, negligible. It would be more than made up by a difference of a few per cent in the number of Americans who could find jobs—perhaps by as little as a difference of  $\frac{1}{2}$  of 1 per cent.

In short, the basic prosperity of the United States is scarcely affected by whether it is on an *international* gold standard or not. As we have already noted, the *domestic* aspect of the gold standard that is important is its psychological significance.

#### IS THIS AN "ISOLATIONIST" POLICY?

As the reader was warned a few pages back, much of the foregoing analysis is likely to evoke the charge of isolationism. This subject is one so heavily charged with emotions and preconceptions as to make cool analysis very difficult. Advocacy of free trade and international trade has long been, I think, the "liberal" position. With some persons, indeed, it seems to command a quasi-religious status. Since the war has started, the attention of thoughtful Americans has been frequently directed to the question of the right and proper place for our country in the economic and political world.

The economic policy that has been presented in this chapter is definitely not internationalist. It is not, however, nationalistic in any invidious sense. Perhaps it were best described by the less colorful word "individualistic." This individualistic program, I trust it has been made clear, is presented not out of selfishness, nor lack of interest in the economic well-being of other nations, nor out of unwillingness to cooperate, but solely because the analysis indicates that the problem of unemployment in the United States will yield to a domestic mechanism, and cannot be solved by any of the suggested international plans. Indeed, the analysis presented herein indicates that one of the most helpful things that our country could do for the family of nations would be to develop and install an effective prosperity apparatus. Its successful operation would then constitute an open invitation to other nations to use all or part of the system to their benefit, as well as contribute directly to their prosperity, by providing stabilized markets.

This conclusion in no way affects the possibilities of American participation in an international *political* organization devoted to preserving the peace. This our country surely will and should do; but such participation does not need to be accompanied by any type of international economic activity, nor are the individualist economic policy and the internationalist political policy incompatible or inconsistent.

#### INTERNATIONAL ECONOMIC COÖPERATION

Does the foregoing analysis lead to the conclusion that the United States ought to reduce its foreign trade, and cut down its international lending? Not at all. It leads

only to the milder conclusions that there is nothing magical about international dealings, and that they have some drawbacks; that, for the United States, the secret of full employment lies not in international policies, but in domestic ones; and that the greatest contribution that the United States could make to world prosperity would be the adoption of an effective domestic program for full employment.

The United States should not reduce its international dealings; on the contrary, it should participate not only in the world peace organization, but in world economic arrangements such as the Monetary Fund and the International Bank proposed by the Bretton Woods agreements. This recommendation may seem flatly contradictory to the reasoning of this chapter, but it is not. Our participation in such international economic arrangements is urged not because *we* would gain much thereby. We would gain little, if anything. No; our participation is urged because it would be helpful to the other countries of the world, and therefore it is the right and proper thing to do. These economic and financial arrangements would be exceedingly helpful to many countries; and the proposals need United States support and coöperation. Our participation therefore would be a friendly thing and a contribution to the peacetime success of the United Nations.

## Peace and Prosperity

WITH A SORT of grim irony the war brought prosperity and full employment to our country, after a decade of peacetime depression and unemployment. But the war-time prosperity did not bring reassurance. Our people are wondering what peace will bring.

With the coming of peace most of 17 millions of war workers will no longer be needed to produce war goods. About 10 million servicemen will be released, and returned to civilian life. What will happen then? Will all these millions be able to find jobs? Will industry be able to employ all those who seek work? Shall we again see stouthearted men selling apples on street corners? Or can we achieve and maintain a high level of prosperity, and do it within the framework of individual enterprise and democracy? Can we provide plenty of jobs for ex-war workers and veterans in the demobilization period, and, what is really much more important, can we go on providing plenty of jobs at good pay in the decades that lie ahead? The demobilization and reconversion period will be relatively short. The real test will come in the long-run period, after the transition period is completely ended, and when the nation is fully back to the normal operations of peacetime.

### THE FUTURE OF THE AMERICAN POLITICO- ECONOMIC SYSTEM

The achievement of full employment by methods involving extensive government controls would be distasteful to most of the American people. Therefore, it is im-

portant to ask some key questions about the proposed positive program, and to get clear answers to them. Does the program mean an extension of government control? and, Does it mean a blueprinted economy? Does it involve regimentation?

The answer to all of these questions is, No. The program would not involve the government's telling anyone in private industry what he may do or what he may not do. The government would not "plan production," nor control any business operations, nor regiment anybody. No; the program is merely a gigantic underwriting of the demand for goods, by measures aimed at maintaining the income of the American people. The people would be completely free to buy the goods that they wanted, and to reject the others. Manufacturers and traders would be entirely free to make, handle, and sell whatever goods they preferred. The program leaves free enterprise free; and undertakes to make that freedom prosperous by guaranteeing an adequate demand for goods. Industry can provide jobs and make good profits only when industry can readily sell the goods that the workers can produce. The program aims at insuring a continuous big market for the big stream of goods that the American economy is capable of turning out when it is running at full speed, thereby encouraging and permitting it to run at full speed.

The American free enterprise system will not long survive unless it provides continuous full employment. Should large-scale unemployment become chronic in the 1950's or later, and be succeeded by a business slump which carried unemployment up to 20 million or 25 million, some sort of violent change in our politico-economic

system would certainly grow out of the people's desperation. What name and what precise form the new system would have are unpredictable. Whatever its name, however, the new system would almost certainly involve less free enterprise and more collective control.

This is the only way in which the present American politico-economic system could be threatened by revolution. It is not threatened by foreign forces. Revolution could come in America only as a consequence of prolonged and widespread unemployment.

With proper management, however, our present system will survive and create real freedom from want. With an adequate prosperity program the American people could enjoy full employment and a steadily rising standard of living. As early as 1950 the average worker would earn about \$1,900 a year. The average family income (from multiple personal earnings and other sources) would be about \$3,000 per year. These figures would increase as the years went by, and would be doubled in about 40 years. At the same time the average work week would decline; in 30 or 40 more years it would be down to 30 hours per week. New comforts and new luxuries would become increasingly a part of the standard of living of the mass of the people. The continuation of our technological, industrial, and engineering progress will make this happy condition not a mere imaginative dream but, potentially, a practical reality. It will become an actual reality if the country's financial mechanisms are brought up to the level of the country's technical machinery.

## THE RECONVERSION PERIOD

It would be desirable to have the prosperity program established in time for the new policies and the new agencies, the Federal Stabilization Board and the Federal Stabilization Advisory Committee, to aid in handling the problems of the reconversion from war to peace, even though these problems differ in many respects from the long-run employment problem, toward which the program is aimed. War production has employed some 17 million workers in industrial plants, service trades, and agriculture. These purchases eventually will drop to a relatively small figure and at about the same time military demobilization will occur. About 10 million men and women will leave the Armed Services.

An ideal transition would require that, concurrently with the progress of industrial and military demobilization, the production of non-war, civilian products (both capital goods and consumer goods) be increased so as to afford employment for the war workers and the returning veterans. Actually, of course, absolutely perfect synchronization is not possible. For example, if an automobile plant stops producing tanks on Saturday night, it cannot start making automobiles Monday morning. Physical plant reconversion takes time; and so does the reconversion of the manufacturers who supply the auto maker with carburetors, upholstery, and other parts. Some industries, of course, can reconvert faster than others. But the general rule will be that, even if the demand for the civilian goods exists, it will be a little while before workers can be employed in the non-war activities. In other words, there is bound to be some temporary,

transitional unemployment, even though forward sales are good and demand is high.

This is an important point, because it focuses attention on the difference between (1) unemployment that is caused by an inadequate demand for goods; and (2) transitional unemployment that is not caused by a shortage of demand but rather is caused by certain temporary factors involved in the process of changing over from war production to peace production.

Monetary policy can help to prevent the first type of unemployment; however, it cannot do anything about the latter. It is the function of monetary policy to see that the demand for goods is adequate during the transition period, if such guarantee is necessary. This will prevent what may be called cyclical unemployment; but it cannot reduce the magnitude of temporary reconversion unemployment, for the latter depends on other factors.

There are, however, other types of policies and actions that can reduce somewhat the magnitude of the reconversion-frictional unemployment. They include the following:

1. Skillful handling of cutbacks of war production programs and the concomitant contract cancellations.
2. Prompt settlement of claims arising from contract cancellations.
3. Swift and sensible disposal of surplus war goods and war plants.
4. Careful advance planning by business management, anticipating and providing against factors that would delay the reconversion process.
5. Relaxation of wartime controls over production, materials, manpower, and prices, as rapidly as is safe.



The foregoing policies and actions will help to reduce the amount of temporary transitional unemployment. This type of unemployment, however, cannot be eliminated entirely. Many war workers and returning veterans will have to wait a few days or weeks or even, in some cases, months, before securing employment in the industry which they prefer. This is unfortunate, but inevitable. If, however, the demand for goods is maintained, this reconversion unemployment will not last long.

The transition period will be characterized by a special temporary condition—*yesterday's* demand for goods will be added to *today's*. Some persons believe that these combined demands will be large enough to provide an ample market for all the goods that can be produced with everybody employed. Some persons go farther—they believe that, temporarily at least, the active demand for goods will be so large, and will exceed the supply so much that inflationary pressure will be created. The continuation of price control would be a guarantee against this danger; and the Stabilization Board would have its deflationary weapons, for use if necessary.

During the war many consumer goods and capital goods have not been produced or have been produced in only limited quantities. Homes, automobiles, and washing machines are familiar examples of missing consumer goods. Trucks, boilers, and railway equipment are examples of relatively unavailable capital goods. At the same time, both consumers and businesses have been accumulating cash and other liquid assets, which are available to pay for the goods when once again they are available.

Some attempts have been made to measure both of

these things—the vacuum of goods and the surplusage of liquid savings. They vary somewhat, but all estimates run into tens of billions of dollars. Whether a relatively high estimate is correct or a relatively low one, it is quite clear that if consumers and businesses rush to spend these funds, a hectic state of demand would result, at least for a brief period. But will they? This is the key question. Are consumers and businesses going to buy madly, even in the face of still higher prices? May not a major fraction of these enormous savings represent an accumulation of assets which our people were not able to accomplish during the Great Depression? To the extent that this is true, and it must be true to a large extent, consumers will not spend these liquid assets, but will hold them. Moreover, the experience of the prewar decade, coupled with current doubts, may make people cautious and willing to spend only when they see fairly permanent employment ahead, and when they are able to buy satisfactory goods at reasonable prices. Businesses may also be cautious—pursuing a careful, wait-and-see policy before embarking on large programs of plant expansion and purchase of new machinery and equipment.

Certainly it is safe to say that the same old familiar factor—psychology—will be the all-important consideration. The state of mind and the expectations of the business community, of investors, and of consumers will govern the magnitude of private spending.

#### THE LONG-RUN PERIOD

The foregoing analysis suggests that, during the re-conversion period, business may be sufficiently good so that no monetary stimulus will be needed in order to

secure full employment. Perhaps, indeed, some restrictive controls will be necessary. The period is likely to be a turbulent one. Some prices will be declining, others straining upward. Employment will be slumping in some plants and localities, rising in others. The over-all pattern may be fairly steady, but the deviations from the averages are likely to be temporarily very numerous. The Federal Stabilization Board and the Federal Stabilization Advisory Committee would be able to assist in handling these special problems and would also be prepared to take action should the general situation show signs of getting out of hand or of slumping seriously. At the same time they could be perfecting their organization, and developing procedures and policies.

The Board, counseled by the Advisory Committee and aided by a research and statistical staff, would have as one of its first jobs the establishment of machinery for the continuing collection and analysis of the necessary data, statistical and otherwise, to give intelligent guidance to action. Many of these data represent figures that are already available, to some extent at least. Probably it would be necessary to expand some of the series, and to take steps to secure greater accuracy in the figures, or more complete coverage. Only experience and careful analysis could determine finally what information would be necessary. It seems reasonably certain, however, that reliable figures on the following significant factors would be useful:

1. Employment
2. Unemployment
3. Money
4. Velocity of turnover of money

5. Prices
6. Saving
7. Bank debits
8. Investing
9. Profits

The Board may be visualized like an engineer, seated before a group of recording dials and gauges, and having at hand the valves which regulate forces that produce economic warmth or cold. The dials and gauges, of course, represent the economic data listed above. The forces regulated by the valves are the variables which the Board controls—credit control, official pronouncements, and the fiscal-monetary mechanisms of the Full Employment Standard.

The Board would watch the dials and gauges carefully, since they would register the country's economic well-being, and factors which comprise and affect it. If business should show signs of running too rapidly, the proper valves would have to be turned, to chill the enthusiasm a bit. Contrariwise, should signs of a slump occur, appropriate sustaining and stimulating action would have to be taken.

#### ADMINISTRATION OF THE PROGRAM

It may be thought that this is too much power and responsibility to give to any group of men. It may seem that political pressures might cause the mechanism to be a menace to our economic system, and a danger to our liberties.

I disagree. I visualize the Board consisting of seven members, appointed by the President, with the consent of the Senate, holding office for overlapping 10-year

terms. Although the members should be highly paid, I should expect that the immense prestige of the Board would be the compelling reason for outstanding men being pleased to serve. The Board would be far and away the most important agency of the executive branch of the Federal government in the economic field.

The Board would be advised by the Federal Stabilization Advisory Committee, composed of ranking representatives of executive departments and members of appropriate committees of the Senate and the House of Representatives. The Committee would have between ten and twenty members, who should be expected to give most of their time to the problems of stabilization, in Committee activities or in liaison capacity to their several departments, the Senate, and the House. The Board membership should be nonpartisan or bipartisan. The Committee should be bipartisan.

It would be of the first importance that the Congressional members be outstanding men. They would have the task of explaining and interpreting stabilization actions and policies to the Senate and the House, and of winning support for necessary legislation.

Without any specific provision, the Committee would possess an informal veto power over actions of the Board, since the Congressional members would influence the complementary tax laws and appropriations, and could even go so far as to recommend legislation abolishing the Board. In these circumstances, close cooperation between the Board and the Committee would be imperative; and the former would be in no position to be dictatorial.

These bodies would be assisted by a research and statistical staff which should include the best available tal-

ent. The present Federal Reserve staff would make a satisfactory nucleus.

These arrangements, it seems to me, would ensure a very high average of ability and integrity among the members of the Board, the Committee, and the staff. Moreover, since their operations would have to be conducted in the proverbial goldfish bowl (and it is economically as well as politically desirable that they should be, in order to get the full psychological leverage of their controls), they would receive advice and criticism from many newspapers, businessmen, labor leaders, economists, and others.

I believe that these various provisions and safeguards would guarantee a competent personnel, and an administration truly in the public interest.

#### THE LESSONS OF WAR PRODUCTION AND EMPLOYMENT

Postwar America can be a wonderful place, and can become an increasingly wonderful place as the years go by. The performance of the American economy during the war has furnished final proof of the immense productive capacity of the American economic machine. As government spending for war goods soared to undreamed-of heights, and government borrowing from the banks pushed the quantity of money up to new highs, the output of America's farms and factories shot up to unbelievable levels. And this "miracle of production" was achieved despite the absorption of nearly twelve million of the country's strongest men into the Armed Services. The story is told simply and devoid of drama in the accompanying table of cold statistics (Table 20).

TABLE 20  
KEY FACTORS IN THE AMERICAN ECONOMY, 1940-1944

	Governmental Expenditures	Governmental Receipts	Adjusted Amount of Money	National Income
	<i>(In billions of dollars)</i>			
1940 .....	\$ 9.7	\$ 5.9	\$ 67.0	\$ 77.6
1941 .....	12.8	7.6	74.2	96.9
1942 .....	32.4	12.8	81.2	121.6
1943 .....	78.2	22.3	102.2	147.9
1944 .....	93.7	44.1	117.7	158.0

	Industrial Production (1935-39 = 100)	Prices (1926 = 100)	Number of Employed	Number of Unemployed
	<i>(In millions)</i>			
1940 .....	125	78.6	45.1	8.0
1941 .....	162	87.3	46.0	6.0
1942 .....	199	98.8	50.2	3.2
1943 .....	239	103.1	51.2	1.1
1944 .....	235	104.3	50.5	.9

The story that the figures tell is not short of sensational. Industrial production nearly doubled; the national income more than doubled (some of this was rise of prices); employment rose, and unemployment dropped to almost nothing. In effect, Uncle Sam said to industry: "Produce all the (war) goods that you can. Don't worry about not being able to find a market for your output. I will buy all that you produce, and shall wish that it were more." With this guarantee, with the lid of inadequate demand taken off of industry, American management and workers proceeded to astonish almost everyone by the volume of their output.

Unfortunately, nearly half of the great stream of goods and services had to be composed of material for war. If that great stream of output had been composed of peacetime goods, and even if the stream had been slightly smaller, the result would have been something like a 50 per cent increase over 1939 in the real income of the American nation.

#### WHAT OF THE FUTURE?

People are asking, If full employment, full production, high wages, and high profits are possible under a War Production Board, why aren't they possible under a Peace Production Board? It is a good question, and a proper question, and one that demands an effective answer. In the technological or engineering sense, these high goals are entirely possible. Indeed, production progress will make possible even higher goals as the years go by. The technological gains that the next few decades will bring are reflected in Table 21.

TABLE 21  
KEY FACTORS IN THE POTENTIAL ECONOMIC PROGRESS  
OF THE UNITED STATES, 1950-1980

	The entire United States				Averages per Person		
	Population ( <i>In millions</i> )	Money ( <i>In billions</i> )	Wealth ( <i>In billions</i> )	Income ( <i>In billions</i> )	Money	Wealth	Income
1950 .....	148	\$119	\$ 700	\$144	\$ 804	\$4,730	\$ 973
1960 .....	161	173	910	188	1,075	5,652	1,168
1970 .....	173	255	1,180	246	1,474	6,821	1,422
1980 .....	182	363	1,452	315	1,995	7,978	1,731

This table shows the bright economic future which is technologically possible for the people of the United



States. It pictures the potential growth in population, productivity, and standard of living. Its attainment, with a shorter work week, would mean more than mere freedom from want. It would mean comfort for the masses. It would mean that an entire people had enough goods and enough leisure and enough freedom from fear and insecurity to make a beginning on the important job of living the good life. This happy condition is technologically within our grasp. It is not a dream; it is a real potentiality.

Our job is to make the potentiality become actuality. This requires that the business and financial system be operated so as to release the almost limitless possibilities of the technological-production machine. I believe that it can be done, by means of the program described in this book. And can be done, moreover, without totalitarianism or regimentation, with a minimum of governmental action, and a maximum of enterprise and freedom.

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